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Ministry of
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Ontario Study of the Service Sector



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ONTARIO STUDY OF THE SERVICE SECTOR

Government of Ontario
Ministry of Treasury and Economics
December 1986

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October 31, 1986

The Honourable Robert Nixon,
Treasurer of Ontario,
Queen's Park,
Toronto.

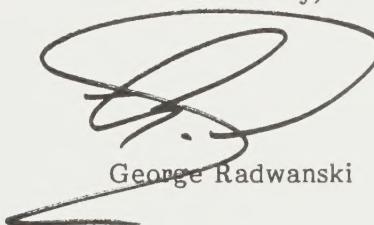
Dear Mr. Nixon:

In October, 1985, I was asked to undertake a study of the service sector in Ontario, and to report my findings to you within a year.

Some preliminary findings of this study were made public in a May 1986 Budget Paper entitled Background Notes on the Service Sector in Ontario.

In submitting this final report, I wish to express my appreciation for having been entrusted with the opportunity to explore vital issues regarding our changing economy.

Yours sincerely,



George Radwanski

Acknowledgements

This report was made possible by the dedication and invaluable efforts, insights and assistance of the members of the service sector study team: Research Director/Executive Assistant Jennifer Dickson; Ray Boyce, Stephen Orsini, Shanthi Weerasekera and Doug Welwood from the Ministry of Treasury and Economics; Fred Lazar from York University; Colin Macfarlane, who was seconded for a time from the Ministry of the Environment; and Secretary Annette Sequeira. They have my deep gratitude, and my admiration for the quality and quantity of the work they performed under constant time pressure.

I also want to particularly thank all the staff of the Ministry of Treasury and Economics, where this study was based, for their help. We drew heavily on the resources of the ministry's library, statistics unit, and production facilities, and the people in each were unfailingly generous with their time and expertise.

A great many other people, too numerous to mention individually, throughout the Ontario Government and in the private sector contributed to the work of this study with assistance, ideas and cooperation. I am deeply appreciative.

G.R.

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Ontario Study of the Service Sector BACKGROUND PAPERS:

DEMOGRAPHIC PROFILES

Women and the Service Sector
Youth and the Service Sector

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EXPORT OPPORTUNITIES FOR ONTARIO SERVICE SECTOR

INTRODUCTION

This study began as an effort to identify ways in which the Government of Ontario could enhance growth and export opportunities in various specific service industries such as engineering, design and banking. The course of this work rapidly became a voyage of discovery into a phenomenon that, I am now convinced, should be recognized as a broad context for all government policy-making activities: We are in the midst of a socio-economic transformation every bit as fundamental as the earlier shift from the agrarian to the industrial eras.

As outlined in the interim report of this study last spring, this transformation may roughly be characterized as a shift in economic predominance from the production of goods to the provision of services, and from exploitation of material resources to reliance on human knowledge. Some experts call it the dawning of a "post-industrial" era; others refer to an "information economy;" others yet speak of the "service economy." These are differences of emphasis and focus; what is inescapably clear is that the transformation is occurring - not only in Ontario, but also in Canada as a whole, in the U.S., and in more than a dozen other advanced industrialized countries.

Here in Ontario, the service sector - which is defined in this study as comprising all economic activity other than the primary industries and manufacturing - now accounts for 73 per cent of employment, 70.2 per cent of Gross Domestic Product and an estimated 80 per cent of all new jobs that will be created over the next decade.

These numbers are more than a statistical artifact, something to be acknowledged in passing before proceeding with business as usual. The profound changes they reflect have implications that touch on virtually every aspect of our lives in this province - our capacity to create future jobs and prosperity, our education system, our network of social programs, our approach to the priorities of public policy.

It therefore seems inevitable that our capacity to understand the nature of this transformation, and the excellence of our response to its imperatives and opportunities, will play an important role in determining our place and our quality of life in a rapidly changing, increasingly challenging world.

To assist in broadening that understanding and formulating that response, the year-long work of this study has included extensive review of the relevant literature; analysis of available statistical data, with efforts to bridge numerous statistical gaps by developing new information where feasible; and consultations with representatives of service sector industry groups, academic experts and government officials.

The earlier phase of this study identified a number of opportunities for action by the Ontario Government with regard to the service sector, and some significant steps have already been taken:

The Speech from the Throne in April contained commitments to expand the role of the Ontario International Corporation to enable it to be a world-class marketing body for this province's private- and public-sector services; to cooperate with the private sector in establishing a Canadian Insurance Exchange in Toronto; and to pursue the inclusion of Toronto in any federal designation of Canadian cities as International Banking Centers. The Budget in May extended the scope of Small Business Development Corporations to include certain types of business services.

Some additional options for industry-specific measures will be addressed in this report.

But piecemeal measures - a new program here, a specific-industry incentive there - would not in themselves suffice as a response, despite the individual merits of any given initiative. In the absence of a broader context, such a flurry of efforts would likely be short-lived, soon to be overtaken by some other perceived priority.

On the other hand, it would not be helpful to attempt some sort of comprehensive policy blueprint that mapped out, once and for all, the specifics of everything that must be done to complete our adjustment to a post-industrial society; any expectation of such a fully detailed blueprint from this study will of necessity have to be disappointed. Because we are still in a period of rapid and accelerating change in which the outcome of future developments - both domestic and international - cannot be predicted with any precision, policy must be formulated with an eye on a moving target. What the circumstances require is neither a mere scattering of measures nor a rigid compendium of tactics, but rather a broad and flexible strategy within which detailed policies can be developed.

This report will discuss some elements of such a strategy. In addition, it will explore such issues as the potential effects of a free trade deal with the U.S. on the service sector in Ontario. And it will provide brief profiles of key service industries in Ontario, with suggestions for policy initiatives where appropriate.

The basic findings that serve as a foundation for this report were set out in detail in the interim report, made public last May as a Budget Paper entitled "Background Notes on the Service Sector in Ontario." To avoid inducing a sense of *deja vu* by repeating those findings at length here, the interim report is instead provided in its entirety for convenient reference as an Appendix.

PART ONE:
A STRATEGY FRAMEWORK

I. OVERVIEW

A strategy for addressing the opportunities and challenges of our new economy should have the following goals:

1.) To ensure that changing circumstances do not deprive Ontarians of the opportunity to have a job or other meaningful form of participating in the economy.

2.) To ensure that, in a changing world economy in which our potential sources of competitive advantage are different from those of the past, we will remain able to generate sufficient wealth to maintain a satisfactory standard of living for Ontarians.

3.) To ensure our ability to ease the uncertainties of economic transition, to assist the economically disadvantaged, and to meet growing social needs.

It is a finding of this study that the development of a strategy in pursuit of these goals should include the following elements:

a.) A clear and broadly shared perception of the economy in which we are now operating and an understanding of how assumptions and approaches that were appropriate to an earlier era should now be modified. This understanding can then inform the entire policy process and provide a context for the broad range of decisions that affect our social and economic development.

b.) Recognition of four key themes that can serve as a policy framework:

- the vital role of education;
- the importance of entrepreneurship;
- the need for social services;
- the export potential of the service sector.

c.) Creation of appropriate structures and mechanisms to monitor the continuing process of change, to identify new opportunities and challenges rapidly as they arise, and to coordinate the implementation of appropriate responses across the broad range of government activities.

Each of these elements will be discussed in detail below.

II. UNDERSTANDING OUR NEW ECONOMY

1.) Adjusting the Picture

"There is an island in the ocean," wrote the great American journalist Walter Lippman, "where in 1914 a few Englishmen, Frenchmen and Germans lived. No cable reaches that island, and the British mail steamer comes but once in sixty days." When that ship arrived in mid-September, the islanders "learned that for over six weeks now those of them who were English and those of them who were French had been fighting in behalf of the sanctity of treaties against those of them who were Germans. For six strange weeks they had acted as if they were friends, when in fact they were enemies There was a time for each man when he was still adjusted to an environment that no longer existed."¹

Thus, concluded Lippman, public opinion is based not on objective reality but on "the pictures in our heads ... Whatever we believe to be a true picture, we treat as if it were the environment itself. What each man does is based not on direct and certain knowledge, but on pictures made by himself or given to him. If his atlas tells him the world is flat he will not sail near what he believes to be the edge of our planet for fear of falling off."²

This analysis has application to our current situation. While we may know intellectually that we are already in a very different economic environment from the one that shaped current assumptions and institutions, the "pictures in our heads" have not yet been redrawn to reflect this reality. We still tend to think of ourselves as living in an industrial economy organized - in terms of its development policies and its priorities - primarily around the manufacturing sector.

Consider, for instance:

- More Ontarians are now employed in hospitals (162,212) than in the auto manufacturing and auto parts industries combined (92,584);³
- More Ontarians are employed in universities and colleges (64,159) than in iron and steel mills (38,376);⁴

Yet we still tend to regard public-sector financial assistance or incentives to such goods-producing industries as automobiles or steel as the only valid field for job-creation measures, while expenditure on expanding hospitals or universities is seen in a very different light. It is regarded as "soft" spending, justifiable in terms of health care or education, but not - despite the obvious employment benefits - as an equally appropriate form of job-creation.

More generally, the earlier work of this study has found that federal and Ontario economic development policy-making in such areas as taxation, assistance programs and export efforts has until now focussed predominantly on the manufacturing and primary sectors, with the service sector receiving relatively little explicit attention. (Appendix, Paragraphs 42-48)

Such unrevised perceptions are not surprising at this stage of our transition and they exist, to one extent or another, in all the societies undergoing this phenomenon. But an indispensable first step in developing a new strategy is to arrive at an accurate, and broadly shared, picture of the circumstances we are now in.

2.) Defining the Change

The emergence of the service sector as the largest component of our economy does not mean that manufacturing is no longer important, any more than the transition from agrarian to industrial society meant that farming no longer mattered. We obviously will continue to need goods, just as we have continued to need food.

What has changed, now in the case of goods as earlier in the case of food, is the share of a society's resources and efforts required to meet those needs.

Advances in technology and techniques made it possible for progressively fewer people to produce increasing amounts of food, while a rapidly growing manufacturing sector absorbed the displaced workers and became the main focus of attention; capacity to produce all the needed food was increasingly taken for granted. Similarly, automation and other factors are now steadily reducing the share of the labor force needed for goods production,

while the service sector has become by far the largest economic component in terms of both employment and output.

The previous transition from an agriculture-based economy to a manufacturing-based one has not meant that farming is now ignored in terms of policy. Indeed, the network of agricultural support measures is far more elaborate and sophisticated than in the past. So, too, it would not make sense to suggest, or to fear, that we need no longer pay attention to goods production. The goods-producing and service sectors are complementary, not competitive. Service inputs make a vital contribution to the quality and the efficiency of our manufacturing, while manufacturing provides a market and an anchor for a significant portion of service sector activity. A balanced policy must be one that maximizes the opportunities of all the components of our economy.

But just as it would have been impossible and unrealistic to continue focussing policy attention overwhelmingly on agriculture once a great majority of the labor force was employed elsewhere, so too it is necessary to recognize that the characteristics and needs of society in a predominantly service economy are different from those in a predominantly manufacturing one.

To explore those new characteristics and needs, it is useful to review first some basic findings about our current situation:

- The growth of the service sector is not a sudden phenomenon but a steady progression over the past 40 years. It is geographically widespread, extending to more than a dozen other advanced industrialized countries; in Canada as a whole, the service sector now accounts for 75.6 per cent of employment and 72.4 per cent of Gross Domestic Product, and in the U.S. it accounts for 76.8 per cent of employment and 73.3 per cent of GDP. Because this emergence of the service sector as the largest component of our economy appears irreversible, it is not useful to debate whether the shift to a "service economy" is desirable. It is already an inescapable fact of life. (Appendix, Paragraphs 2,4,6)

- By far the greatest employment growth in the service sector over the past four decades has been not in such mainly consumer services as restaurants, cleaners or barbershops, but in comparatively knowledge-intensive

producer or business services - which include finance, insurance, real estate, employment agencies and personnel services, computer services, security and investigation, accounting, advertising, architects, engineering and scientific services, lawyers and notaries, management consultants and miscellaneous services to business management - and health care and education. Between 1941 and 1981, employment in these services grew by more than 700 per cent, while mainly consumer services grew by only 179 per cent. (Appendix, Paragraphs 18-22)

- There appears to be no persuasive basis for a view that services are somehow inherently inferior to goods production as a form of wealth creation - in terms of being somehow less "real," valuable or desirable - in today's economy. Nor would it be accurate to perceive the service sector as a mere "by-product" of manufacturing. Only about 35 per cent of the total output of intermediate services goes to the manufacturing and primary sectors; the remaining 65 per cent goes to other services. (Appendix, Paragraphs 27-29)

3.) Strategic Considerations

Taking these basic findings as a point of departure, it is appropriate to focus next on how these changing circumstances are likely to affect us over the next 10 or 20 years - that is, to focus on how the emerging new economy differs fundamentally from the previous one, and on some of the strategic considerations that should therefore guide the shaping of related policies.

Strategic Consideration #1: Manufacturing will remain vital as a source of output and wealth creation, but we can no longer look to this sector as a major source of future new employment.

Manufacturing processes around the world are rapidly being modified through such forms of automation as robots, computer-assisted design

and computer-assisted manufacturing (CAD/CAM). Fully automated production plants are already a reality, and they are likely to become widespread in the future. The result is that it will take fewer and fewer people to produce all the goods we can consume or hope to sell.

This new era of automation is still in its earliest stages, and Canada has until now lagged behind a number of other advanced industrialized countries in the pace of diffusion. In 1984, Japan had 32.1 robots per 10,000 employed manufacturing workers; West Germany had 7.2; the U.S. had 4.7 - and Canada, which ranked ninth out of 10 countries, had only 3.7.⁵

But even if the absolute numbers of automated units in this country are still relatively small, the rate of change is nonetheless significant: Here in Ontario, in 1975 there were only 11 industrial robots installed; by 1985, there were 976 - and 739 of these were installed after 1980.⁶

Our prospects for the years ahead in this regard appear to narrow down to two choices: Either we will sharply accelerate our adoption of the new labor-saving technologies, or we will lose ground to our foreign competitors because of lower productivity and higher product costs. Either way, the need for blue-collar labor in manufacturing will be likely to decline.

As American management expert Peter Drucker puts it: "Production has come 'uncoupled' from employment ... A country, an industry or a company that puts the preservation of blue-collar manufacturing jobs ahead of international competitiveness (which implies a steady shrinkage of such jobs) will soon have neither production nor jobs. The attempt to preserve such blue-collar jobs is actually a prescription for unemployment."⁷

While more automated forms of production require less input of labor and materials, they require more input of information and knowledge. Increasingly, therefore, the jobs related to our present manufacturing industries will require not blue-collar workers but computer programmers, engineers, designers, scientists and planners. These are all essentially "service" activities, whether or not they are carried out within a manufacturing company. In fact, many of these activities can readily be contracted out to independent firms in

the service sector or - since so much of our manufacturing is foreign-owned - carried out at parent companies abroad.

It does not appear realistic to hope that the prospect of a diminishing employment role for manufacturing can be reversed by the emergence of sophisticated new industries. Vital as the output of such "high-tech" industries will undoubtedly be to our future prosperity and competitiveness, the reality is that these industries are not very labor-intensive from the outset. To cite just one example, labor costs account for only some 12 per cent of the total manufacturing costs of a semi-conductor microchip. Most of the rest is spent on research, development and testing - knowledge-intensive activities that involve only relatively small numbers of highly specialized people.

It is difficult to put credence, consequently, in the often-preferred aphorism that if robots replace people in many manufacturing jobs, it just means that there will be new jobs for people in manufacturing robots. The reality is that, for the most part, robots will manufacture robots - and so far, in any event, we're importing virtually all of them from other countries.

This does not mean that great numbers of manufacturing jobs will be disappearing overnight; the changes envisaged here are likely to be spread over decades. Nor is it meant to suggest that no new manufacturing jobs will be created; there undoubtedly will be some. The pace of change, and the prospects for new manufacturing jobs, are certainly open to debate. What does appear inescapably clear is that, even in the most optimistic scenarios, we cannot rely on the manufacturing sector to be a major source of future employment growth.

Strategic Consideration #2: Our best hope for competitive advantage in international trade lies not in the mass production of goods, but in the specialized application of knowledge.

Like most advanced industrialized economies, we no longer have any great comparative advantage in the mass production even of quite sophisticated goods. Automation and technology transfer make it increasingly possible for newly-industrializing countries to produce most kinds of standardized goods, with access to cheaper labor and often cheaper raw materials.

This does not necessarily mean that we are moving toward a future where virtually all our manufactured goods will be imported from developing countries, because at a certain point transportation costs become an important consideration. If technology makes it possible to produce goods almost anywhere and labor inputs become insignificant, then there can be a strong argument for producing them close to their markets. What such a scenario suggests is that our potential to export mass-produced goods could be greatly reduced.

If a rapidly growing number of countries can efficiently manufacture mass-produced goods, it clearly follows that for advanced industrial economies the most promising competitive role in manufacturing lies in two areas: the production of those complex goods that require a high degree of flexibility, know-how and sophistication; and innovation in the development of new products or the improvement of existing ones. It is here that, by virtue of our more advanced expertise and higher levels of education, we can hope to retain comparative advantage over competitors in the newly-industrializing countries.

Indeed, already-visible trends toward the internationalization of production suggest the possibility that while the high-value-added, knowledge-intensive activities - product development, design, research, development of the necessary software for automated manufacturing, and so on - will continue to be carried out in the economically advanced economies, actual production may increasingly be "farmed out" around the world. The industrial challenge for an economy like Ontario's is to ensure that we are competitive on the leading edge of innovation, rather than relegated to the role of a production platform.

What is true of manufacturing is even more true of the service sector: One of the key characteristics of our service economy is that it is knowledge-intensive. As one of still relatively few "post-industrial" societies in a world predominantly composed of newly-industrializing countries, we have potential comparative advantage in the form of a comparatively highly-educated population and a relatively high degree of expertise. We need to compete vigorously in the large and growing market for know-how not only in such traditionally tradable services as banking, engineering and computer software, but in a whole host of other knowledge-intensive services needed by increasingly affluent developing countries seeking to build up their infrastructure: health care, education, agricultural technology, project management, business planning, and so on.

Strategic Consideration #3: In our new economy, comparative advantage is not static but dynamic - that is, it can be created by appropriate strategies.

Economic theory in industrial economies generally regarded comparative advantage as static, because it depended on geography and such relatively unchangeable factors as access to raw materials, cheap labor and capital.

But as noted earlier, these traditional sources of comparative advantage are no longer the main determinants of success in our new knowledge-intensive global economy.

The emphasis is shifting from such accidents of nature or demographics to the outputs of the human mind. Key factors include a country's or firm's creativity and adaptability; capacity for strategic planning; and inventiveness in developing new goods and services and new combinations of goods and/or services, and so on.

As University of California professor Chalmers Johnson puts it: "The newer dynamic concept of comparative advantage replaces the classical criteria with such elements as human creative power, foresight, a highly educated work force, organizational talent, the ability to choose and the ability to adapt. Moreover, these attributes are not conceived of as natural endowments but as qualities achieved through public policies such as education, organized research and investment in social overhead capital."⁸

It is important to note the great potential for creating comparative advantage through innovation in assembling combinations of goods and services, or services and other services. A steadily diminishing proportion of economic activity involves isolated, "pure" goods or services.

Instead, we find ourselves dealing increasingly with what French economist Albert Bressand calls "complex packages" or "compacs." Thus, for instance, anyone who buys a MacDonald's hamburger is actually purchasing a "compac" with the following elements: some meat and other standardized edible items (a good); a highly efficient time-saving process (a service, namely the "fast" side of the fast-food package); other services such as an implicit guarantee of cleanliness, nutritional content, etc.; and the absence of other services (such as bringing food to customers' tables) the provision of which may be seen as entailing unnecessary cost.⁹

A competitor, consequently, might seek comparative advantage by assembling a "compac" in which one or several elements are different: the hamburger itself might be prepared or presented differently (char-broiled, for instance); the process might be modified to make it less time-saving but more personalized (offering a wide choice of toppings, for instance); or the emphasis might be on a very different kind of restaurant design to provide a different atmosphere.

The range of ways in which comparative advantage can be created through the assembly of innovative packages is virtually limitless.

Combining a sea cruise with shipboard seminars conducted by famous experts, for instance, might attract a clientele that would not be drawn by competitors either offering only a cruise on a comparable vessel or inviting people to invest considerable time in similar seminars alone.

Similarly, a city or a province can formulate a strategy to attract certain types of business not only through direct incentives, but also by ensuring the availability of other services that can act as a "magnet." Thus, for instance, New York City's role as a cultural and media center undoubtedly helps it to attract individuals and business seeking to be where the action is. Similarly, Toronto's role as Canada's financial center is a magnet that helps attract related businesses as well as head offices.

Strategic Consideration #4: In the previous industrial economy, the most important inputs were capital and raw materials; in the emerging new economy, the most important inputs are people and knowledge.

In virtually every service sector industry, the most important determinant of success or failure is the human factor: the skills, knowledge and performance of the people involved. A restaurant is unlikely to thrive if its waiters are ill-informed, slow and forgetful. An airline whose staff are skilled and efficient enough to adhere to schedules is likely to fare better than one whose performance is unpredictable due to poor planning and sloppy work. The quality of a bank, a hospital or an engineering firm depends predominantly on the expertise and judgment of their respective personnel.

Consequently technological change in the service sector, unlike in manufacturing, is primarily embodied in labor. Manufacturing firms typically improve efficiency or quality by installing new equipment. In a service field such as health care, education, engineering or management consulting, modernization is accomplished mainly by retraining the people already in place or by hiring new graduates familiar with more up-to-date techniques.

Against the background of these considerations, in view of both the changing international competitive environment and the role the service sector has assumed as a source of employment and output, it is recommended:

1. That all future economic development policies such as tax measures, industrial assistance, and export promotion initiatives be considered by the Government of Ontario in a context that fully recognizes the importance of the service sector to our economy.

III. THE VITAL ROLE OF EDUCATION

Strategic Consideration #5: To compete effectively in a new knowledge-intensive global economy that relies primarily on human capital, excellence in educating our work force is our single most important strategic weapon.

Education is as vitally fundamental an element of public infrastructure in the new knowledge-based economy as roads, railways, ports and power sources were in the previous predominantly manufacturing-oriented one.

An economically advanced society's ability to compete will depend increasingly on having sufficient world-class experts to provide innovation and leadership, and a general work force with the skills and the flexibility to carry out sophisticated and rapidly-changing tasks. And for individuals, having a suitable education will increasingly be the key to obtaining satisfying, well-paid employment.

Recognition of the importance of education as a contributor to economic growth is by no means new. In his landmark 1962 study of the sources of economic growth in the United States, Edward P. Denison wrote: "It is not surprising to find that improved education has made a major contribution to economic growth. By my calculations, from 1929 to 1957 it raised the average quality of labor by 29.6 per cent" and accounted for 23 per cent of the growth rate of the economy.¹⁰

What distinguishes our present situation from the past is that, in a knowledge-intensive world economy, education and knowledge have moved from being among the important contributors to being arguably the paramount ingredients for competitive success.

1.) Education and Employment

As Thierry J. Noyelle, research scholar at Columbia University's Conservation of Human Resources Project, puts it: "In a manufacturing economy, almost anyone was employable if he or she were willing to make the effort to work. In a service economy, this is no longer true."¹¹

If the logic of the new technologies is to automate an ever-increasing amount of low-skilled work, then it follows that the satisfactory employment available will increasingly involve only skilled work. This is as true in the service sector as it is in manufacturing. We are only beginning to see the first signs - in the form of automated teller machines in banks, computerized filing and accounting systems in offices, and so on - of the extent to which routine labor in service activities can be replaced by technologies.

Contrary to widespread belief, computerization does not reduce the skills needed by workers; rather, it increases them. It is not a matter of learning to push a few buttons, and leaving it to the machinery to do the thinking. Instead, what appears to be happening is that each worker's range of responsibility and decision-making is broadened.

In part, this occurs because the most efficient use of the new technologies often involves having one person do tasks that used to be parcelled out among several. Thus, for instance, a business might previously have had a system in which a telephone clerk recorded a customer's order, then passed it on to a succession of others who would check the availability of what had been ordered, verify the client's credit-worthiness, prepare and send the bill, arrange for shipping from a warehouse, file documents pertaining to the transaction, and so on. Now it may be feasible, and far more efficient, for a single person at a computer terminal to take the telephone order and carry out all or most of these functions - but this obviously requires such a person to be capable of making a far broader range of decisions than under the previous segmentation of tasks.

More generally, as automated machinery becomes increasingly capable of carrying out routine tasks, the need for human labor increasingly involves doing what the machines cannot. This includes such activities as

diagnosing what is wrong when the technology fails to perform tasks satisfactorily, problem-solving in matters that fall outside the routine, handling human relations tasks, developing new ideas and so on.

Apart from gradually reducing the availability of employment for people without skills, the growing importance of knowledge in our economy is truncating the traditional career advancement ladder. It is becoming increasingly difficult for someone with a relatively low level of education to advance by learning on the job.

In the past, it was conceivable to start as a teller and work one's way up to the presidency of a bank, or to start in the stockroom and eventually become a top executive of a department store. Now hiring from outside takes place at various levels along the ladder and all but the lowest positions are open only to people who arrive with the necessary training. Without leaving the work force for a great deal of additional education, a young worker's chances of advancing from the stockroom to senior management are about the same as those of advancing from flight attendant to jetliner pilot.

Statistical data dramatically underscore the increasingly vital link between education and employment. In Ontario in 1985, the unemployment rate among people with only a high-school education was 9.8 per cent. Among people with some post-secondary education, it was 7.5 per cent. Among those with a post-secondary certificate or diploma, it was 5.4 per cent. And among university graduates, it was only 4 per cent.¹²

2.) Changing Educational Requirements

While academic credentials based essentially on level of education attained are a key to the employment market for individuals, having a well-educated work force requires something more. It is a matter not only of number of years of schooling, but of the quality and focus of education received during those years.

In this regard Ontario, like most advanced societies undergoing the transition to the new economy, has some important questions to address.

Our primary and secondary school system initially developed with an eye to the prevailing needs of an industrial society. Consequently, the values it tended to stress included rote learning, discipline and obedience to authority in a hierarchical structure, and the acquisition of specific skills.

The trend over the years, through a succession of reforms, has been to introduce into the system ever more flexibility and room for personal choice by students. The thinking that prevailed by the 1960s and 1970s is aptly captured by W.G. Fleming's summation of the recommendations of the Provincial Committee on Aims and Objectives of Education, or the Hall-Dennis report, of 1968: "The committee seemed to feel that the school could insulate itself against the outside world and persuade the child that his best achievement could be appraised independently of external standards and expectations. That is, if he proved no match for arithmetic, but developed passable talent in art, the world would not attach any stigma of failure to him."¹³

But neither the "traditional" priorities of our earlier education system nor the extremely subjective standards of more recent "progressive" experiments are fully adequate to meet the needs of our changing economy. On one hand, the values of rote learning, discipline and highly specific skills that were prized in the industrial work force are being replaced by a new set of desirable attributes: ability to think, ability to make independent decisions, and flexibility. On the other, proficiency in a certain core of skills is more vital than ever, and an overly flexible approach to education cannot ensure that all graduates will possess those skills.

A great deal more is rightly expected of our education system than merely preparing young people for the work force. It is also expected to play a role in preparing them more generally for life, and for citizenship. The attributes of a genuinely literate person - a knowledge of history, geography, the arts, political institutions, different cultures, and so on - are perhaps even more important in today's complex world than in the past. No satisfactory set of educational priorities can underestimate the importance of these elements. But from the narrower economic perspective that is the primary focus of this study, it appears vital that our education system must prepare people for the work force in what may roughly be categorized as two fundamental areas: "basic" skills and "intellectual" skills.

"Basic" skills are, quite simply, a prerequisite to functioning effectively in any sophisticated task. They include the ability to read and comprehend reasonably complex material; the ability to write coherently with a sound grasp of spelling and grammar; the ability to communicate verbally with some clarity; and the ability to handle at least moderately complex mathematical tasks. In addition, our new economy will increasingly require computer literacy and, more broadly, technological literacy and at least a rudimentary understanding of science.

Because the jobs of the future will be increasingly knowledge-intensive, as discussed above, people deficient in these basic skills will be at a serious disadvantage. Someone with weak reading comprehension, for instance, will have difficulty assimilating information related to changing tasks. A person who cannot spell will have great trouble using many types of computerized data bases. This is scarcely new in itself, of course; it has always been important to be able to read, write and count. What is new, however, is that there will be fewer and fewer jobs in which a lack of proficiency in such skills is either irrelevant or disguised - and yet, if the comments of employers are any indication, the level of attainment in these areas among recent graduates is not uniformly satisfactory.

But proficiency in these "basic" skills will not suffice. One of the distinguishing characteristics of the new economy is that information and knowledge are being generated at such a rate that change is constant. It is no longer realistic to think of education in terms of a body of knowledge that can be divided into categories and imparted, once and for all, to young people before they get on with their lives; rather, being able to function in our society will involve a life-long learning process for which the initial schooling years can provide only a base.

Many people will have to expect to change occupations two or three times in the course of their lives as some types of jobs become obsolete and a need for new ones arises. And within existing occupations, new technologies and techniques will bring so much change that it is possible to envisage a need for some degree of retraining every few years.

Beyond acquiring specific skills, therefore, it is imperative that young people emerge from our school system with "intellectual" skills and aptitudes that will permit them to adapt, and to readily assimilate new knowledge, throughout their lives. On this point, experts are virtually unanimous.

As A.R. Dobell, President of the Institute for Research on Public Policy, puts it: "It is simply not possible to predict what kind of skills will be needed in the work force even five years from now. Consequently, a worker with mechanical training in specific skills is bound to be in a far less advantageous position than one who has learned how to study, think independently and learn quickly."¹⁴

Thinking clearly and learning effectively are not necessarily natural aptitudes. They are skills that can be learned - and no function of our education system is more important than specifically teaching those skills.

"Learning to think" can be taught by building into the curriculum at all levels programs specifically designed to develop the ability to analyze, synthesize, evaluate, distinguish the relevant from the peripheral and fact from opinion, solve problems and make decisions. Schools and educators would undoubtedly argue, with justification, that such instruction is already diffused to one degree or another throughout the curriculum. But what appears essential now is to go beyond this, to identify clear thinking as a specific skill to be taught in a planned way, with careful monitoring of the progress and developmental needs of each student.

Similarly, effective learning habits - the set of skills that enables a person to quickly identify, assimilate and apply the relevant information in any field of endeavour - need to be taught and monitored on their own merits, not only in relation to a student's grasp of any given academic subject.

For these reasons, it is recommended:

2. That the Government of Ontario, in cooperation with school boards across the province, put high priority on curriculum development and other appropriate measures to ensure that by high school graduation all students have full proficiency in "basic" skills - reading comprehension; coherent writing with sound spelling and grammar; mathematics; computer familiarity; and some understanding of science - as well as specific training in clear thinking and effective learning.

In order to ensure that the subjective goal of excellence in education is consistently translated into objective results, it appears inescapably necessary that there be clear, province-wide standards. That has not been the case since the abolition of Grade 13 departmental exams in 1967. Standards and priorities now vary considerably from board to board, and indeed from school to school.

Critics of rigid, province-wide testing offer two major types of objection. First, it discriminates against students who may be good at academic subjects but bad at performing under the pressure conditions of an exam. And, second, such reliance on objective standards tends to encourage "teaching the exam" - that is, emphasizing rote memorization rather than creativity and intellectual exploration.

One can readily sympathize with the first argument. But the reality is that virtually every student who graduates into the labor force will at some time be subjected to "exam-like" conditions - a job interview, the need to perform effectively in an important sales presentation or a meeting, the need to carry out a demanding task under deadline pressure. Students who have difficulty performing under such circumstances might perhaps benefit more in school from assistance with this problem than from being spared the experience.

Whatever the merits of the second argument when applied to such relatively subjective fields as literature or history, however, it is difficult to see its application to the "basic" skills outlined above. A student can read a given passage and comprehend its main points, or he or she cannot. A student knows how to spell and how to construct sentences in accordance with the rules of grammar, or he or she does not. A student is able to perform a given mathematical operation and arrive at the correct result, or he or she is not. Rather than stifle creativity or impede learning, standardized province-wide testing in these subjects - not only at the conclusion of high school, but at intervals throughout the school years - would provide a means of quality control and of identifying students whose skills require further development.

It is therefore recommended:

3. That, as a means of ensuring that all students acquire proficiency in the basic academic skills, the Government of Ontario seriously consider instituting standardized province-wide testing in those skills at appropriate intervals during the primary and secondary school years.

3.) The Role of the Universities

Our universities have a three-fold role to play in helping to meet the opportunities and challenges of our new economy: They must produce the well-educated generalists and the highly-trained specialists essential to having a knowledgeable work force. They should be world-class centers of research, innovation and creativity. And they can serve as "magnets" to attract clusters of sophisticated private-sector activity seeking to draw on their expertise and resources.

The ability of any given university to play these roles depends a great deal on the resources it can bring to bear: the expertise, creativity and reputations of its professors; the ratio of faculty to students, which determines the degree of individual attention available; the quality of the physical plant,

including libraries and research facilities; the availability of funding for research, and so on.

a.) University Funding

Consequently, there is cause for serious concern about the financial circumstances under which Ontario's universities have been operating in recent years. Our system of post-secondary education has never had a more important role to play in our economic development than it will in the years ahead - and yet its capacity to carry out that role adequately, let alone with excellence, would be thrown profoundly into question were there to be a continuation of the manifest underfunding of recent years.

Ontario ranks next to last among the 10 provinces in the level of its operating grants to universities per full-time-equivalent student. Even more significantly, when adjustments for inflation are made, the real value of per-student operating grants to Ontario universities has declined by 12.5 per cent over the 10 years between 1975-76 and 1985-86.¹⁵

It appears appropriate, at the very least, to bring Ontario's per-student operating grants up to the average for the other nine provinces. For 1985-86, the average level of operating grants per full-time-equivalent student in the other nine provinces is \$6,171 - 11.4 per cent more than the comparable Ontario figure of \$5,539.¹⁶

The cost of increasing Ontario's grants by 11.4 per cent to bring them up to the nine-province average would be approximately \$142 million. That would represent an increase of 4.5 per cent in total Ontario expenditures on education. Apart from bringing Ontario grants up to the average of the other nine provinces, an increase of this magnitude would have the effect of bringing the real value of these grants almost back to the level of 10 years ago.

Society always has to make difficult choices regarding the allocation of scarce resources. But under-investing in our system of higher education would be an illusory saving, as ultimately self-defeating as it would have been to permit the factories of the industrial era to run out of sources of energy.

b.) Allocation of Resources

While it appears indisputable that our universities require a substantial infusion of new funding, however, there is also reason to doubt that the system as a whole is making the most efficient use of the resources it already has.

It would be difficult to subscribe to a view that Ontario has, in absolute terms, significantly too many universities. Massachusetts, for instance, has more than 120 colleges and universities - and this concentration has provided the basis for an economic development strategy based on attracting knowledge-intensive private sector industries.

But our universities are all publicly funded, and it is imperative that the system as a whole use all available funds as cost-effectively as possible in pursuit of academic excellence. To the extent that our universities compete with each other instead of pooling their efforts in various fields or concentrating on different areas of specialization, there is inevitably potential for waste and duplication of effort. It seems highly questionable, for instance, whether Ontario really needs nine separate and competing faculties of education, six law schools and five medical schools.

Of even greater concern is the fact that such diffusion of efforts and resources can make it much more difficult for any given university to develop the critical mass - in terms of number and quality of researchers, scale of research facilities, and so on - that leads to world-scale accomplishments.

On the other hand, the concept of critical mass in academic terms should not be defined too narrowly. It can develop not only from concentrating within one institution a great deal of expertise and resources in a single field such as engineering, but also from creating within an institution a synergy between concentrations of expertise in different disciplines - engineering and computer sciences, for instance, or business administration and the social sciences.

If institutional specialization had the effect of increasingly isolating academics and students from contacts with their counterparts in other

disciplines, our system would be the poorer for it. But it does not follow from this that every university need necessarily offer every possible field of study; a more selective pursuit of inter-disciplinary synergy might suffice. For that matter, exposing students to different fields of study does not necessarily require that all those fields be physically contiguous on the same campus. The experience of students might instead be broadened, for instance, by having some degree programs incorporate periods of study at several different campuses across Ontario.

There has been no shortage of suggested ways to rationalize our university system. Perhaps the most intellectually attractive option would be a variation on the recommendation of the Spinks Commission in the mid-1960s that all Ontario universities become campuses of a single province-wide super-institution: To maintain some diversity and choice for students, it might be preferable to have two distinct "super-universities" - one encompassing the University of Toronto along with such institutions as Waterloo, Queen's, University of Western Ontario and McMaster, and the other comprising York University and the other universities around the province.

But speculations about what might be optimal have to be tempered by recognition of the risk of temporarily paralyzing the educational capacity of our system in the process of seeking to improve it. Great reorganizations tend to lead at least temporarily to great confusion, and neither the rest of the world nor the educational needs of our students would stand still while our system coped with the upheavals of a total restructuring. A more modest and gradualistic approach, consequently, seems far more realistic.

Such an approach would involve two key elements: Increasing concentration by each of our universities on those fields of specialized study in which it has attained or has the best hope of attaining world-class excellence, and increasing cooperation among our universities to complement each other's areas of excellence.

As various universities built up their respective areas of strength and phased out or at least de-emphasized areas of relative weakness, inter-university cooperation would become all the more important.

There appears to be no inherent reason, for instance, why students pursuing a degree at one Ontario university should not routinely be able and encouraged to obtain a semester's or an academic year's worth of credits at another university within the province that is particularly strong at some given courses. Indeed, if the universities are within commuting distance of each other, students at one might be encouraged to go to the other even for a single course that it is better equipped to provide.

By the same token, it makes sense for research within different Ontario universities to be undertaken on a cooperative or complementary rather than a competitive basis. It suffices that researchers at various Ontario universities be invigorated by competition with their counterparts in other provinces or, better still, other countries. The opportunity for significant breakthroughs - to say nothing of the efficient use of scarce funds - can clearly be enhanced if within Ontario there is a strong sense that everyone is on the same team. Such cooperative approaches and exchanges of information can be greatly facilitated by the availability of new information technologies and computer networks.

The universities are understandably sensitive about maintaining their independence. But because the universities are supported by disbursement of large amounts of public funds, the Government has not only a right but an obligation to ensure that an increase in those funds is spent as cost-effectively as possible to enhance the excellence of our education system.

It is therefore recommended:

4. That funding for universities be substantially increased, in the context of a cooperative effort between the universities and the Government, and among the universities themselves, to reduce needless duplication of effort and to channel incremental funds toward the building up of centers of excellence within each university.

c.) "Boundary-spanning" Skills

Just as in the case of elementary and secondary education, it is imperative that the universities assist students not only in acquiring specific knowledge but also in refining the skills they will need regardless of what occupation they pursue after graduation.

Thus, if it is to remain true that a person who has a university education is better equipped for a role in the labor force than one who does not, a university graduate should have developed superior skills in such vital areas as communication, problem-solving and decision-making.

As Science Council of Canada Chairman Stuart Smith points out, for instance: "Studies show that over 50 per cent of the time of a modern engineer in high-technology industry is spent writing reports. The need for communication is absolutely essential; the use of language is paramount throughout the world of work."¹⁷

Just as knowledge is of only limited use if it cannot be effectively communicated, so too it can only help an individual in his or her contribution to the work force if it can be effectively applied to problem-solving and decision-making. These skills should be taught in our universities, consequently, either through specific compulsory courses or through emphasis on problem-solving and decision-making in the teaching approaches to all fields of study.

In this regard, it is also worth noting that the traditional approach to university education has been to compartmentalize knowledge and information into distinct disciplines - sociology, psychology, economics or engineering, for instance - that are taught as separate subjects. But to teach effective problem-solving and decision-making in the context of today's society, it may be important to take a more inter-disciplinary approach that stresses the interaction between different bodies of knowledge.

Thus, for instance, a mandatory course in the final academic year might involve having students work in teams on solving a complex problem or devising a plan by drawing on various disciplines they have studied. In envisaging the university of the future, American educator Samuel L. Dunn offers this example of such an approach:

"A student might tackle the problem of planning a new suburb. In the process of working with this problem the student would have to work with a great deal of information in the disciplines of sociology, urban planning, statistics, business, the biological and environmental sciences, and law... Preparing written and oral reports would sharpen communications skills, and accessing information from data banks and interviewing experts would add retrieval skills."¹⁸

Apart from such a general emphasis on integrating various fields of knowledge, our new economy requires the development of specific sets of boundary-spanning expertise.

To be optimally effective exporters of consulting engineering, for instance, we need to have some engineers who are also trained experts at marketing, or business and marketing experts who also have a solid basic grasp of engineering.

As the findings of a recent survey of 130 Ontario firms employing scientists, engineers, computer specialists and technicians put it: "Many of the new high-technology production processes emphasize the need for people who can work effectively in the context of multi-disciplinary teams and understand how to go beyond the boundaries of their own discipline or training. This kind of boundary spanning ability is reflected in the need for people who can blend sales or marketing skills with a strong grasp of technical principles. The term 'sales engineer' aptly describes one such emerging occupational specialty. It is difficult to imagine, for example, effectively marketing new computer systems to customers without possessing such a blend of technical and sales expertise."¹⁹

It is therefore recommended:

5. That Ontario colleges and universities place major emphasis on developing students' communication, problem-solving and decision-making skills in all fields of study, with an integrated inter-disciplinary approach whenever possible.

and

6. That, to produce the boundary-spanning expertise needed in some areas of our economy, Ontario universities intensify efforts to develop special programs of combined study in such fields as marketing and engineering.

d.) International Marketing

Despite the enormous importance of foreign trade to Ontario's economy, none of our universities at present offers a comprehensive world-class program of study in international marketing and business.

The business schools at various universities offer some internationally-oriented courses, and in some instances students may be able to take a concentration of courses in this field. But what is lacking is a top-notch center of excellence which could attract Ontarians interested in international trade and produce significant numbers of specialized experts, while also carrying out leading-edge academic research.

Such a major international and marketing center or institute, which should be attached to one of the existing university schools of business, could also play a very valuable role in providing seminars and special abbreviated programs of study for established members of the business community seeking to increase their expertise in international trade.

It is therefore recommended:

7. That the Government take the lead in discussions with Ontario universities to establish a world-class center or institute for the study of international trade and marketing associated with one of the existing business schools and with access to related teaching of foreign languages, and that the Government ensure the availability of the necessary funding for such a center or institute.

e.) Education and the Workplace

No discussion of the role of education in our new economy would be complete without emphasizing the degree to which the traditional distinctions between education and work are becoming outdated.

It used to be assumed that people would spend a certain number of early years acquiring an education, and the rest of their lives "out in the world." The current reality is that continuing education is becoming a lifelong requirement.

Adults will periodically have to turn to educational or training institutions in order to broaden their knowledge or skills, to become acquainted with new technologies or techniques in their field of work, or to become qualified for new occupations as previous ones become obsolete. By the same token, students will be better prepared for the work force if their academic years include opportunity for some meaningful experience in their fields of interest.

As the Report of the Commission on the Financing of Elementary and Secondary Education in Ontario aptly put it: "Education then, in an integrated view, is not separate from employment; education is, in fact, a form of employment. If we think of employment as gainful work, then an individual's life career is made up of periods of work in which what is gained is at times a salary and at other times knowledge. These two kinds of employment will become more intertwined and mutually enriching throughout an individual's life than ever before."²⁰

For the universities, this means that they will have to anticipate, and be prepared to accommodate, a growing influx of mature and part-time students with needs and expectations different from those of people coming directly from high school.

And for the high schools, this highlights the importance of bridging the gap between the education system and the workforce. One of the most effective ways of doing this is through co-op education programs, which arrange for students to obtain some exposure during their school years to the type of work they are contemplating pursuing after graduation.

The value of such programs is by no means limited to students who intend to go directly into the workforce after graduation. Students who intend to go into medicine or law, for instance, could benefit from the opportunity to spend some time respectively at a hospital or a law firm, thereby obtaining a realistic view of what the profession entails and providing a clearer context for their future studies.

While there is already a substantial and growing network of co-op education programs, the level of commitment to this approach still varies significantly from school board to school board and from school to school.

It is therefore recommended:

8. That the Government continue and further reinforce its support for co-op education programs, working in cooperation with school boards and the business community toward ensuring the availability of a full co-op program in every Ontario high school.

IV. THE IMPORTANCE OF ENTREPRENEURSHIP

Strategic Consideration #6: By far the most important engines of employment growth in our new economy are not large corporations but small businesses in the service sector, and particularly new small business start-ups.

As automation reduces the need for production labor, as new information technologies reduce the need for clerical staff and middle management, and as specialized service functions are increasingly contracted out, a great many large corporations are downsizing. At the same time, an "entrepreneurial explosion" is leading to the start-up of large numbers of small businesses primarily in the service sector.

The number of new business start-ups recorded in Ontario in the 1985/86 fiscal year was 56.5 per cent greater than five years earlier in 1979/80 - an increase from 62,000 to 98,000 new businesses started in a given year.²¹

Nearly 90 per cent of all firms in the service sector have fewer than 20 employees. And some 33 per cent of total service sector employment is in firms with 49 or fewer employees (the proportion is not higher because this sector also includes huge employers such as hospitals, utilities, transportation companies, etc.) In manufacturing, by contrast, only some 13 per cent of employees are in firms of this size. (Appendix, Para. 37)

1.) Importance of Start-ups

What is of particular interest here, however, is not so much the smallness of service sector firms as their newness. It is the start-up of new businesses - and the expansion of young, recently-started ones as they carve out for themselves a place in the market - that provides a strong source of incremental employment.

As Marie-Josée Drouin of the Hudson Institute points out: "There seems to be a misconception that it's small and medium-sized businesses that create all the jobs. The important feature is not that they're small and medium-sized - it's that they're new. By definition the new firms are generally small, but it's the creation of new business, allowing birth and death of new business, which creates momentum in the economy."²²

While the service sector accounts for well in excess of 80 per cent of all new jobs created in Ontario, various studies appear to confirm that births of new firms - rather than expansions of established ones - in turn account for by far the largest share of those new service sector jobs. The Ministry of Industry, Trade and Technology estimates, for instance, that births of new businesses accounted for 71 per cent of all new service sector jobs created between 1976 and 1985.²³

It is worth noting that women are playing an important role in this expansion of entrepreneurial activity. The proportion of business proprietors in Canada who are women nearly doubled between 1970 and 1980, from 14.8 per cent to 29 per cent.²⁴

While the data are at best fragmentary, there are also indications that business start-ups by women may be experiencing a higher success rate than those by men: One study found that of nearly 2,000 businesses sampled in 1978, only 25 per cent of the male-owned firms were still operating three years later, while 47 per cent of the female-owned ventures had survived.²⁵ Other statistics suggest that the failure rate for first-time female entrepreneurs is up to 50 per cent lower than for first-time male entrepreneurs.²⁶ Against this background, the contribution of small businesses run by women to economic growth and job creation would be an appropriate subject for further study.

2.) Opportunities for Entrepreneurship

Since we have moved from an economy in which the key strategic resource was capital to one in which it is knowledge, it is not surprising that an upsurge in entrepreneurship is occurring. On one hand, it is relatively easy to start one's own small service sector business or to acquire a franchise; on the other, the more uncertain are the prospects for obtaining or keeping a job in a large established firm, the more tempting it becomes to set out on one's own.

As John Naisbitt and Patricia Aburdene wrote in their book, *Reinventing the Corporation*: "In the industrial society, it took megabucks to build a plant or factory. Now you need a telephone, a kitchen table, a customer and you are in business. Provided you have a vision, belief in yourself, and the unique ability to turn your vision into a reality."²⁷

This trend appears likely to continue and even accelerate, fuelled by new developments in communications and information technology as well as by the emergence of specialized new business and consumer needs.

Indeed, entrepreneurship in the service sector can be an option not only for individuals but also for established firms in manufacturing. For instance:

- The knowledge or expertise that a company has built up for internal use - whether it be the development of specialized computer software, for instance, or the management of occupational safety programs - may be worth marketing as a service to other companies.
- The goods that a company manufactures may be worth combining with a related service to increase the market for the goods while providing incremental revenues; one example of this would be a manufacturer of agricultural chemicals establishing a lawn treatment service.
- A company's excess capacity - whether it be in storage facilities, vehicles or equipment, maintenance facilities, or computer time - might be worth marketing as a service sector profit center.
- The nature of a manufacturing company's business may provide a basis for forward integration into the service sector, either by establishing retail outlets or by establishing a credit subsidiary to provide financing for dealers or customers.

Whether new businesses are started by individuals or by existing companies, such entrepreneurship tends to provide not only direct increases in employment and economic activity, but also additional benefits to the economy: When a new business is created or begins to get a foothold, there is likely to be

need for construction, renovation or at least rental of premises, purchase or leasing of furniture and/or equipment, advertising and so on.

3.) Helping Small Business

The relatively high failure rate suggests, however, that starting a small business may be easier than making a success of it. Some new enterprises fail simply because there is insufficient demand for what they are trying to sell, or because they are in a field where competition is too intense.

But other small businesses fail for more potentially preventable reasons: inadequate access to capital for start-up or expansion; lack of access to management expertise; and lack of access to market intelligence.

Because a dynamic small business sector is the most important source of employment growth in our new economy, it makes sense for public policy to put high priority on helping to reduce these problems.

a.) Access to Capital

The small size of many service sector businesses, combined with lingering perceptions that investing in manufacturing is somehow more solid, tends to restrict their access to equity capital and to force them to rely disproportionately on debt financing. In 1984, only 14 per cent of the number, and 26 per cent of the total dollar amount, of investments made by venture capitalists went to service sector firms - even though this sector is by far the largest component of our economy.²⁸

Because they tend to be knowledge- and people-intensive and therefore have relatively little collateral, small service sector firms often find even debt financing difficult to obtain and expensive. And when they do obtain it, the reliance on debt rather than equity makes these firms vulnerable in the event of short-term cash flow problems or unanticipated increases in interest rates.

Lack of access to equity capital becomes a particularly acute problem at the point when small businesses, having successfully passed the

start-up period, seek to expand. Having been required to commit all available personal and business collateral to obtain the initial start-up financing, the owners often are unable to obtain additional loans and the enterprise begins to stagnate or founder. This may in considerable part explain the federal Department of Regional Industrial Expansion's finding that while some 12 to 15 per cent of small firms in the U.S. - where there is readier access to venture capital - grow eventually into large firms, the comparable figure for Canada is only 3 to 5 per cent.²⁹

In the judgment of this study, the Ontario Government's Small Business Development Corporations program is the most effective way to address the lack of access to equity capital for small service sector businesses.

Until earlier this year, eligibility for the SBDC program was limited to small businesses in manufacturing and processing, tourism, research and development, book publishing, software development and, in Northern and Eastern Ontario, services ancillary to the mining and forestry industries.

The May 13, 1986, Ontario Budget took an important step forward by extending eligibility to a number of business services - specifically, computer services; architectural, engineering and other scientific and related technical services; and services ancillary to manufacturing, such as electroplaters, foundries and milling operations.

There appears to be no inherent reason, other than resolvable administration and supervision problems, why incorporated firms in other service sector industries should remain excluded from eligibility in the long term. It would be appropriate, rather, to continue the gradual expansion of the program, with eligibility extended next to other incorporated business services, specifically:

- employment agencies and personnel suppliers;
- accounting and bookkeeping services;
- advertising services;
- management consulting services; and

- other business services, such as:
 - security and investigation services;
 - credit bureau services;
 - collection agencies;
 - customs brokers;
 - duplicating services;
 - design services.

It is therefore recommended:

9. That, in order to strengthen the viability and growth potential of small service sector firms, the Government of Ontario facilitate their access to equity capital by extending eligibility for the Small Business Development Corporations program first to all incorporated business services not yet eligible, and then gradually to other service sector industries.

In view of the frequent difficulty and high cost of obtaining start-up funding for small business, and an increasing disposition on the part of people who have become unemployed to start their own businesses, there is also an additional facilitating step the Government could take.

An obvious course for people who want to start a business after losing a job is to invest their severance pay and accumulated pension funds. But because these severance payments and pension withdrawals are subject to taxation, the "critical mass" available for investment in a start-up is significantly reduced. Making such receipts tax-exempt if they are invested in a new business owned by the recipient would assist and encourage entrepreneurial initiatives that benefit our economy as a whole.

This undeniably would be somewhat discriminatory, in the sense that no similar tax benefit is available to someone who invests in a new business not with severance pay but with savings that were originally taxed when received as income. But since it is axiomatic that someone who receives severance pay has

lost his or her job, providing someone in that situation with additional assistance in becoming re-established - and perhaps thereby providing new jobs for others as well - does not seem excessively unfair.

It is therefore recommended:

10. That the Government seriously consider making severance payments and withdrawn accumulated pension funds exempt from income tax if they are invested in a new business owned by the recipient.

b.) Access to Business Expertise and Market Intelligence

Many service sector businesses tend to be started and run by people who are expert in some field of service activity - whether it be computer software, or catering - rather than in management.

Such neophyte entrepreneurs often lack the know-how to produce the sort of sophisticated business plan required to obtain optimal start-up or expansion funding, or the skills to cope with difficulties as the business expands or becomes more complex. Small business owners who find themselves in this situation are seldom able to afford the services of high-quality management consulting firms, at least on an ongoing basis.

Apart from lack of management expertise, operators of small businesses are also often hampered by lack of ready access to information - about various government assistance programs, emerging changes in demand patterns, new domestic or export opportunities or looming competitive threats. Many of them feel they cannot spare the time to attend information seminars, or to spend hours on the telephone seeking information from various levels of government.

The present network of 18 Ministry of Industry, Trade and Technology field offices and 11 offices of the Ontario Development Corporation (ODC), Eastern Ontario Development Corporation (EODC) and Northern Ontario Development Corporation (NODC) across the province is an important source of assistance to small businesses. So also are the 23 branches of the Federal Business Development Bank (FBDB) in this province.

But there remain gaps to be filled.

First, for small business operations outside the centers where these offices are located, obtaining sufficient government information or discussing potentially available assistance can necessitate travel that requires getting away from the business for a day; some people feel unable to spare the time, at least with any frequency.

Second, the availability of free or inexpensive detailed business counselling is limited. MITT field offices provide free advice, but they do not have the resources to provide the kind of lengthy, ongoing counselling that a new or expanding business with a neophyte entrepreneur may need.

The Federal Business Development Bank provides counselling through its Counselling Assistance to Small Enterprise (CASE) program, using retired executives as counsellors. But the scale of the program is relatively small, when measured against the potential need.

The FBDB provides some 4,300 person-days a year of counselling on some 2,500 assignments in Ontario. That works out to an average of less than 2 days per assignment - hardly the kind of ongoing access to expertise and advice that many small businesses would need. And it seems highly unlikely that 2,500 assignments can fully meet the counselling need, when one considers that there are some 270,000 small businesses with fewer than 100 employees in Ontario, and 98,000 start-ups in a single year.

Access to information, and to referral to expert counselling, would be greatly enhanced if the Government established small business information centers or "boutiques" in every municipality with a business community large enough to support one. Each such center would be in a conveniently located storefront or in a government building.

A small business operator would be able to go to such a center in his or her own community and obtain detailed information about eligibility for Ontario or federal government assistance program, about the details of a given tax provision or, for instance, about whether anyone in Ontario is known to be exporting a given good or service to a given country.

An information officer staffing the center would have the answer readily available in the form of reference material, would be able to access it via computer link, or would know whom to call within the government to obtain a quick answer for the clients. These centers would also be the contact point for arranging business counselling for entrepreneurs.

The essential feature of this information network would be its comprehensiveness of geographic coverage and information availability: People would be able to have all their questions answered expeditiously in one place, and that place would be near their place of business. It might be possible to reduce the costs of such a network by establishing the centers in existing public buildings and by working in close cooperation with local Chambers of Commerce, other business groups or municipal governments.

It is therefore recommended:

11. That the Government improve the vital access of small business operators to information and to assistance programs by establishing a comprehensive network of small information centers located in every Ontario municipality with a business community large enough to support one.

Access to public sector assistance for small business might be further simplified by integrating Ontario and federal efforts in this area. This could be done, for instance, by negotiating with the federal government to have Ontario take over the branches of the Federal Business Development Bank in this province and merge them with the operations of the Ontario Development Corporation, the Eastern Ontario Development Corporation and the Northern Ontario Development Corporation.

The work of the federal government's Task Force on Program Review (Nielsen Task Force) has created a potential opportunity for such an arrangement. In its recommendations to the task force, the Study Team on Services and Subsidies to Business suggested privatizing the FBDB's loan portfolio, terminating its lending activities and transferring its merchant banking, counselling and information activities to the provinces to provide "one-stop-shopping" for small businesses.

Stated the team's report: "There are many possibilities here but one would be for the federal government to withdraw from the storefront to the warehouse and allow the provinces to act as retailer of information and management services. Under federal-provincial agreements (ERDA sub-agreements) tailored to the situation in each province, the federal government could use the existing provincial agencies to be the direct contact point with the small businessperson seeking advice. The provincial agency would provide advice on both federal and provincial programs ... From the point of view of the small businessperson, the 'one-stop-shop' option (either at federal or provincial level) is most desirable."³⁰

The new combined operation - which might be called Business Development Centers of Ontario (BDCO) - could provide small and starting-up businesses with merchant banking services, financial planning services, management consulting and marketing counselling services, management training seminars and information services. The comprehensive information center network recommended above could serve as an initial contact point for providing businesses in smaller communities with access to BDCO services.

It is therefore recommended:

12. That the Government seek to provide small businesses with a "one-stop" source of services in merchant banking, financial planning, management and marketing counselling, training and provision of information, for example by exploring with the federal government the possibility of Ontario taking over all activities in this province of

the Federal Business Development Bank other than the existing loan portfolio and integrating them with the activities of the Ontario Development Corporation and the two regional development corporations.

To address the problem of lack of management expertise among many small business owners, it is important to increase the availability of expert counselling.

There are two basic options for doing this. One is to subsidize access to paid consultants, whether they be government-employed in or in the private sector. The other is to recruit advisory expertise primarily on a volunteer basis, either without any financial compensation except reimbursement of expenses or with only modest honoraria.

The disadvantage of the first approach is that the necessary salaries or fees would be costly, and the cost factor would inevitably tend to limit the scope of any such program. A volunteer program might produce somewhat lower efficiency and commitment than the paid approach, but the far lower cost of such a program would permit implementing it on a far broader scale and thus assisting more businesses.

The approach envisaged here would be to tap the experience and expertise of retired executives and entrepreneurs province-wide through a major and high-profile new small business advisory program. Participants would be asked to be available on an ongoing basis as unpaid consultants to one or several businesses in their geographic area, depending on the level of involvement they wished. They might be supported by access to a talent pool of business professors, government experts and management consultants to whom they could turn for advice on particularly difficult cases.

In addition to the obvious benefits for small businesses, such a program - which might be called Expertise Ontario - could also serve a broader purpose. It could provide a challenging, meaningful and satisfying form of activity and community service for the growing number of retired business people Ontario will have as our population ages. This sense of involvement

could be reinforced by such measures as regular newsletters detailing interesting cases or inviting inputs on problems various participants are trying to solve, regional banquets, and perhaps special awards for outstanding accomplishments by entrepreneur-advisor teams under the program.

While the basic approach is similar to that of the FBDB's CASE program, the large-scale province-wide Ontario program envisaged here would be complementary rather than competitive. When one considers CASE's 2,500 assignments in the context of the existence of some 270,000 small businesses with fewer than 100 employees, it appears clear that there is room for substantial additional activity in this area. If the operations of the ODC and FBDB were eventually merged, as discussed above, then the CASE and "Expertise Ontario" programs could also be integrated.

It is therefore recommended:

13. That the Government establish a large-scale, province-wide and high-profile volunteer program of small business counselling services drawing on the expertise of retired executives and entrepreneurs - assisted as needed by business professors, government experts and management consultants - to supplement the federal CASE program and to integrate with it in the event that the ODC and the FBDB are merged.

V. THE NEED FOR SOCIAL SERVICES

Strategic Consideration #7: In an economy where people are the most important asset, a strong network of social support measures is not a financial drain but a vital instrument of economic development.

Social support measures - including unemployment insurance, welfare, universally accessible health care, publicly subsidized housing, counselling, day care for children, and care for the elderly - are the protective link between the individual and the society of which he or she forms a part. They are our means of ensuring that even the most vulnerable among us has access to the basic necessities of life and to at least a minimal participation in our society's affluence.

Such measures are all the more important at a time of major economic transition, when some people have been dislocated by change and many others fear that they might be. A strong sense that we are each other's co-insurers, and that no one will be left alone at the mercy of forces beyond his or her control, can go a long way toward making the uncertainties of rapid change less frightening and unsettling.

While maintaining and strengthening such a sense of protection would be eminently justifiable on grounds of compassion and fairness alone, there are also fundamentally important economic justifications.

1.) Facilitating Industrial Adjustment

First, a safety net of adequate income maintenance and social support measures is absolutely indispensable if people are to accept the continuous industrial adjustment and labor force flexibility that our new

economy requires. It would be absurd to expect workers to cooperate in the introduction of labor-displacing technologies, the need to learn new skills or the prospect of periodic job changes, unless they can feel certain that society will repay that cooperation by meeting their needs if they become displaced.

And yet an alternative scenario of confrontation and resistance would either make adjustment and flexibility impossible, or would at least negate most of the potential benefits. Consequently, a clearly perceived social contract that assures people of sufficient support appears indispensable if we are to maintain and enhance the cooperative approach we need to remain internationally competitive and hence capable of generating sufficient employment and wealth.

2.) Nurturing Human Capital

Second, since a key characteristic of our new economy is its reliance on human capital, it makes eminently good sense to invest in nurturing that capital not only through education but also through ensuring excellent health care, child care, availability of care for elderly dependents, and the absence of excessive anxiety about the possibility of falling into need.

It stands to reason, for instance, not only that a healthy worker will be more productive than an ailing one, but also that a worker distracted by worry about makeshift arrangements for a young child or elderly dependent will likely be less effective than one who is confident that first-rate care is being provided.

As A.R. Dobell, President of the Institute for Research on Public Policy, puts it: "In a world where human resources are key, the birth, nurture, training and support of healthy human beings are the fundamental activities underlying the wealth of nations."³¹

3.) Encouraging Entrepreneurship

As outlined earlier in this report, the major source of employment growth in the service sector has been entrepreneurial activity - that is, the start-up of new small businesses. Such entrepreneurship by definition involves a

certain amount of risk-taking, and the presence of an adequate social safety net plays an important role in enabling individuals to take those risks.

Anyone who gives up his or her job to start a business, or who decides not to seek new employment but to set out independently after losing a job, is obviously taking a gamble: The failure rate for new businesses is considerable. But it is a gamble that it is in society's interest to encourage, given the importance of small business start-ups as a source of new employment and economic activity.

It is a great deal more feasible for an individual to take that gamble if he or she knows that in the worst-case scenario - if the business fails and there is temporarily no private source of income - at least the most basic personal and family needs will be met: Unemployment insurance or welfare will ensure enough money for subsistence, the children will still be able to get a good education without cost, a sick family member won't be denied medical care because of lack of funds, and so on.

Far from discouraging self-reliance as is sometimes argued, consequently, the social safety net helps create an environment where it can be pursued.

4.) Social Measures and Employment

While these considerations argue for maintaining and strengthening the existing network of social support measures, our changing economy also raises some fundamental longer-term issues about the links between work and society.

What appears to be happening is that technological change is gradually modifying the economic and social role of work as we are accustomed to defining it.

Throughout history, the role of human labor has been to produce the goods and services needed by a society. The fewer people worked, the less a society would be able to consume and to export, and the lower its standard of living would be. Hence, anyone who did not work was regarded as not pulling his share.

In recent decades, automation and other factors have begun to alter this picture. Because of a combination of automation, market saturation and competition from newly industrializing countries, it is becoming increasingly possible to produce all the goods we can consume or hope to sell, while employing less than the total potential work force.

While the inherently more labor-intensive service sector has been absorbing much of the labor force overflow, labor-displacing technologies are increasingly being introduced in this sector as well. Employment in the service sector will continue to grow, but it is by no means certain that employment opportunities in the commercial part of this sector will grow sufficiently to absorb all the potentially available labor.

The very fact that this is a concern underscores the nature of the change that is taking place: Work is being transformed, at least partially, from a necessity for production to a means of distributing wealth and social participation.

Employment is regarded as vital in our society for at least three reasons:

- It is the means through which individuals obtain a share in the wealth of our society, and hence the funds to sustain themselves, by earning an income;
- It is one of the most important ways in which individuals have a sense, vital to their self-worth, of participating meaningfully in a society which tends to identify people in terms of what they do for a living;
- It enables people to function as consumers of goods and services, thereby creating economic activity and employment for others.

Thus the pursuit of full employment in today's economy is not so much an economic objective as a political one. We are primarily concerned as a society with generating additional jobs not because we would have insufficient output of goods and services without those jobs, but because without them some people would be unable to earn an income and feel that they are playing a meaningful role.

Arthur J. Cordell, science advisor at the Science Council of Canada, puts it this way: "The connection between work and income, which made sense in a time of material scarcity, now leads to social inequity and at the limit, could undermine the economy. In a society in which the automation of production and services is the norm, the displaced workers who cannot purchase products will suffer as individuals, and their collective decline in effective demand, triggering an economic recession or depression, would lead to social suffering on a broad scale."³²

The traditional response to this challenge has, as Cordell points out, some serious shortcomings: "Many job-creation projects are merely costly mechanisms for distributing income. After a few years the subsidized factory is closed down and the workers are back on unemployment and welfare."³³

A number of new approaches - including increased incidence of part-time work, job-sharing and educational leaves, and a guaranteed annual income - are already being explored or advocated.

But an additional opportunity worthy of exploration is the fit between our employment needs and our social needs. On one hand, the goods-producing and commercial service sectors may not be able in future to produce all the jobs we need; on the other, we face a large and growing need for basic human infrastructure services such as health care, day care for children, care and assistance for the elderly, adult education and retraining, counselling and so on.

Expanding such areas of activity - and a host of other potential "people-helping" services - can provide full-time or part-time employment and a socially meaningful and recognized role for people who might otherwise be unemployed or underemployed, while meeting fundamental needs in our society.

For the reasons outlined above, expenditures on expanding these services are no less economically valid than support for commercial expansion. They are an investment in the nurturing of our human capital, based on a recognition that Ontario's most important resource is its people.

5.) Funding the Investment

Funding an expansion of that investment might be assisted by focussing on the ways in which traditional methods for distributing income in our society have been affected by technological change.

In the previous economy, part of the income from a firm's production of goods was distributed to its workers through their salaries. Part of that, in turn, was distributed to society through the income tax for public spending, and another part was distributed again through workers' consumer spending. Yet another share of the income from production was also obtained for society directly from the firm through corporation taxes.

To see how that is now changing, one need only visualize a hypothetical totally automated production plant. With no production workers, none of the income from the goods the plant produces is distributed through salaries. Consequently, no share of the income is obtained by society through workers' income tax. If one assumes that the plant is foreign-controlled - as is some 59 per cent of Ontario manufacturing output³⁴ - there is also no prospect of obtaining a reasonable portion of the income for society through income tax on recipients of the firm's dividends; most of those dividends will be paid, and taxed, in another country.

The only other basis for distributing a share of income from this hypothetical firm's production is through corporate taxes. But in fact we have been moving away from this form of taxation. In 1965, corporation taxes accounted for 22 per cent of Ontario tax revenues; by 1985, they accounted for only 15.8 per cent.³⁵ Over the same period, the proportion of tax revenues from personal income tax has increased from 25.5 per cent to 40.6 per cent. The proportion from retail sales tax has increased from 19.3 per cent to 30 per cent.³⁶

While the example of a totally automated plant is obviously extreme, the phenomenon it describes is real to whatever degree automation makes it possible to produce the same or greater value of output with fewer workers. We cannot distribute to society a share of that increased profit by taxing the non-existent incomes of the workers who were displaced to make it possible, nor can we obtain sales tax from consumption that those workers cannot afford.

An answer would appear to lie in reviewing the emphasis in our tax system, to enable it to obtain for society a fair share of the incremental employment-less wealth generated by automation in the commercial manufacturing and service sectors. That share, in turn, could be used to help expand the provision of employment and services in human care.

It is therefore recommended:

14. That, to strengthen our competitiveness and capacity for adjustment in a changing economy, maintaining and expanding our network of social support measures - including financial assistance, health care, subsidized housing, counselling, day care for children, and care and services for the elderly - be regarded as a high-priority investment in nurturing our human resources and in creating employment.

and

15. That our income distribution mechanisms, including our tax system, be reviewed to ensure ability to help fund the expansion of these social support measures by obtaining for society a fair share of the profits from the application of labor-displacing technologies.

VI. THE EXPORT POTENTIAL OF SERVICES

Strategic Consideration #8: Virtually every type of service is potentially exportable, and global trade in services may eventually outpace trade in goods.

Trade in services is estimated to account for between 20 and 25 per cent of total international trade, with a U.S. dollar value anywhere between \$350 billion and \$700 billion a year. Precise, up-to-date figures do not exist, because there is no effective international monitoring system for services which, unlike goods, are not subject to registration at customs checkpoints. (Appendix, Paragraphs 49-52)

It has generally been assumed that only some services are tradable, while others are destined by their nature to remain localized.

Thus various studies have identified only the following as tradable services:

Air transportation; accounting; advertising; architecture; automobile and truck leasing; banking; communications; computer services; construction services; educational services; engineering; equipment leasing; franchising; health services; hotels and motels; insurance; legal services; maritime transportation; motion pictures.

The reality, however, is that developments in information and communications technology and in such techniques as franchising have made it possible to export virtually every conceivable service. (Appendix, Paragraphs 53-57)

As Senior Assistant U.S. Trade Representative Geza Feketekuty puts it: "Any service product that can be reduced to electronically coded bits of information can be delivered to any point in the world, with great reliability, at relatively little cost and no time lag."³⁷

The resulting internationalization of services has made it possible, for instance, for U.S. judicial opinions to be abstracted and entered into an electronic data base in Korea, kept on file in Mead Data Central's computers in the United States, and accessed via electronic hook-up by lawyers in London, Paris or Toronto.

Similarly, as "expert systems" come increasingly into use, it may become commonplace for patients to answer questions at a doctor's computer terminal in Hamilton or Ottawa, and have their ailments diagnosed by a sophisticated computer program located in the U.S. or in Europe.

Not all services can be delivered electronically, of course. But others can be embodied in goods that can readily be shipped (for example, books or films); provided by people such as consultants or repair workers travelling abroad; or provided by the establishment of foreign branches. Tourism, which involves people arriving from abroad to spend money directly in the "exporting" country, is another form of service trade.

And for services that cannot conveniently be traded in any of these ways, the rapidly growing practice of franchising provides yet another option. Through franchising, entrepreneurs anywhere in the world can acquire the right to use an operation's name, techniques, advertising and distribution network, and so on.

Because virtually every conceivable service can - at least in theory - be franchised, virtually any service can be traded. If one tried to name services with little apparent trade potential because of their highly localized nature, two that might readily come to mind are the corner convenience store or the neighborhood barbershop. Yet there are now more than 1,000 7-Eleven convenience stores in Japan, and the Fantastic Sam's barbershop chain has more than 1,000 outlets in the U.S. and is expanding its operations to Canada.

1.) Untapped Export Potential

Ontario-based service sector firms are already recognized as world-class international competitors in at least four industries: banking, life insurance, consulting engineering and real estate developments. In a number of other industries, one or several firms are also highly successful in international markets.

But we have barely begun to tap the full potential of international trade in services. Because knowledge and expertise are among the most valuable commodities in today's global marketplace, we have strong export potential in a broad variety of activities - in both the private and the public sectors - that we have until now just taken for granted as part of everyday life. (Appendix, Paragraphs 58, 59)

Highly specialized and sophisticated services can be exported to other advanced industrialized countries. But by far the most promising market for such exports of Ontario expertise - sometimes in packages combining private and public sector knowhow with Ontario-manufactured goods - appears to be in the newly-industrializing countries. As their affluence increases through export of manufactured goods while rapid urbanization brings new pressures, many of these countries will be seeking to expand and modernize their infrastructures.

That, in turn, can provide a market for advanced expertise in everything from waste management and environmental protection to urban transportation and health care management and delivery systems.

The health care field, indeed, provides an example of expertise that could have strong potential for export not only to newly-industrializing countries but also to the U.S.

The U.S. opportunity lies in the management and information systems capacity that the Ontario Government has built up over two decades of administering the Ontario Health Insurance Plan (OHIP). This expertise - in such fields as computer software for patient care, billing, hospital administration, centralized pharmaceutical purchase and distribution - could be

marketed to state medicare systems and to large-scale prepaid health systems organized by insurance companies, hospital services corporations and labor unions.

In the newly-industrializing countries, we could be in a position to offer governments a highly innovative "turnkey" health care package that would include public-sector management and planning expertise, hospital and clinic construction, hospital and clinic administration, and medical, nursing and laboratory training, or any more limited combination of some of the above elements.

In marketing our expertise to the governments of newly-industrializing countries, we have a number of potential advantages over some foreign competitors. First, because Canada is neither a superpower nor a nation with any history of colonialism, our involvement in the development of a country's infrastructure may be more politically palatable. And, second, our mixed economy with a relatively high degree of government involvement enables us to offer foreign governments more public-sector program management than can countries with a more privatized approach.

High-potential areas for export of Ontario services are explored in further detail in the Background Papers of this report.

2.) Selling Our Services

The marketing of services differs from goods marketing in a number of fundamentally important ways.

First, because services are intangible, they generally cannot be sold by providing samples to prospective clients or by putting them on display like goods at a trade fair. Instead, the marketing of services relies heavily on much more subjective factors: reputation, credibility with regard to promised performance, and impressions obtained by the potential buyer from personal contact with the seller of the service.

Second, market intelligence plays an even more critical role than in the case of goods. Many potential buyers would not necessarily know that a

given type of highly specialized service or expertise - or innovative package of complementary services, or of goods and services - is available as an alternative to the way they are handling a particular problem. Hence, they are unlikely to seek it out. This means that the key to marketing success often lies in having sufficiently detailed and analytical knowledge of developments in various countries to be able to identify potential buyers of a given service, and make them aware of its availability, before some competitor does.

And, third, because much of the market for our expertise is in newly-industrializing countries characterized by a high degree of centralized government control over the economy, services marketing is likely to involve dealing with foreign governments much more than with individual companies.

Against this background, it is important to note that much of our untapped service export potential is in small, highly specialized firms, and in the public sector. In both cases, successful marketing abroad will inevitably require substantial government involvement.

Not only do various businesses lack the resources and knowhow to carry out detailed foreign market intelligence operations or to mount extensive selling efforts on their own, many of them are not even aware that they have potentially exportable expertise. A vital need, consequently, is for a body equipped to carry out an export "match-making" function: identify service export potential in our private sector and in the Ontario government, identify potential foreign customers for our services, then help develop the opportunities into deals.

Because many of the firms in question are too small to undertake an export project on their own, and because in some instances the opportunity can only be addressed by offering a package of complementary services or services and goods, this body should also be able to take the lead in assembling those packages and/or assisting the creation of consortia of small firms.

A number of ministries and agencies of the Ontario Government already play an active and successful role in working with the private sector to sell knowledge and specialized skills abroad. (Appendix, Paragraph 62) But the scale of the total effort is not yet equal to the magnitude of the need or the opportunity.

The activities of some of our competitors are instructive in this regard.

The U.S. government has developed a complex network of agency offices, inter-agency committees and private sector advisory groups to support the growth of service exports. The focal point of this network is the International Trade Administration of the Department of Commerce, where services are one of seven "industry clusters" receiving specialized attention (the others are basic industries; capital goods and international construction; textiles and apparel; aerospace; science and electronics; and automotive and consumer goods). This "services cluster" is staffed by 55 people.

Its key activities include informing American firms about export opportunities, and organizing more than 20 major service sector foreign trade missions a year, to enable U.S. firms to establish personal contacts with potential buyers and to increase awareness of what the U.S. service sector has to offer.

In Britain, where services are known as "invisibles," the high-powered British Invisible Exports Council also puts heavy emphasis on trade missions and seminars abroad. This body - composed of representatives of major service sector firms, working with representatives from the government and the Bank of England - organizes more than a dozen large-scale service trade missions a year. The council also receives top-level foreign visitors in London to brief them on what the British service sector has to offer.

A comprehensive program to support and increase Ontario service sector exports can more effectively be carried out by a specialized body than by a line ministry of the Government for several reasons.

First, many of the required activities - initiating the creation of consortia, taking a role as prime contractor in certain government-to-government deals, and so on - can more appropriately, and more speedily, be carried out by a Crown corporation than by the regular mechanisms of government.

Second, and perhaps even more important, paying sufficiently even-handed attention to service sector opportunities at a time when many assumptions from the previous manufacturing-dominated economy still linger in our society, requires a kind of deliberate effort akin to "affirmative action." It appears vital that a campaign to increase Ontario's service sector exports be carried out by a specialized body that has such a campaign as its only priority and the sole focus for its energies, without competition from other sectors for attention and resources.

It is therefore recommended:

16. That a specialized agency of the Government, dedicated exclusively to the promotion of trade in services and related goods, be given the mandate and the resources to:

- carry out an ongoing and highly sophisticated market intelligence function to identify potential customers for Ontario service exports, with particular emphasis on newly-industrializing countries, and convey the information to potential exporters;
- maintain a detailed, up-to-date inventory of service export potential in both our private sector and within the Ontario government, and identify potential private- and public-sector linkages as well as linkages with the export of manufactured goods;
- promote Ontario's service-exporting capacity through trade missions, publications, advertising, etc., as well as through support and assistance for pursuit of specific deals by Ontario firms;

- serve as a central marketing agency for all service exports by the Ontario government;
- where appropriate, initiate the assembly of packages that combine government expertise with private sector services and/or goods, and market or assist in marketing those packages;
- where appropriate, take the lead in assisting the formation of consortia of small private sector firms to provide a service that these firms would be unable to export individually;
- in instances where direct government-to-government deals provide a competitive advantage, take a role as prime contractor on behalf of qualified private sector companies, subject to appropriate performance guarantees; and
- provide advice to Ontario service exporters on the structuring of financing packages for potential deals.

3.) Procurement Policies

In a very real sense, international competitiveness begins at home. That is, Ontario firms will be better positioned to compete abroad if there is a sufficient demand for their services within this province to enable them to develop "critical mass" in terms of size, experience and a track record of successful performance.

In some instances, the procurement policies of the Government can play an important role in providing that substantial domestic market for Ontario firms.

The experience of Quebec is instructive in that regard. The emergence in that province of three huge, internationally active consulting engineering firms - Lavalin, SNC and Monenco - is largely attributable to the fact that work on Hydro Quebec's massive hydro-electric projects was contracted out to the private sector.

The policy of Ontario Hydro, in contrast, has been to carry out its projects with predominantly in-house personnel. Our engineering profession argues vigorously, and with apparent justification, that this has inhibited the development in Ontario of firms with similar international stature to those in the Quebec industry.

In a variety of other professional and technical fields as well - data processing or the development of software, for instance, or various types of specialized consulting - the Government and its agencies can assist the growth and export potential of Ontario firms by contracting out as much work as possible in preference to doing it in-house.

Since domestic firms have a far greater tendency to be active exporters than do subsidiaries of foreign firms, it would also make sense to give preference to Canadian-owned enterprises in this sort of contracting out.

It is therefore recommended:

17. That, in order to assist Ontario firms in attaining the size and experience desirable to compete effectively in international markets, the Government pursue a policy of contracting out as much as possible of its professional and technical work to qualified private sector firms, and that preference in this regard be given to Canadian-owned enterprises because of the greater likelihood that they will develop an export orientation.

4.) Human Resources

Ontario has a potential trade advantage in the cultural diversity of this province's population. We have highly-skilled people of virtually every national origin in the world, and their knowledge of the languages and customs of other countries can be a powerful asset in the pursuit of foreign markets.

Successful export marketing requires not only an attractive product and effective basic salesmanship, but also an understanding of the language, business practices, expectations and cultural differences particular to any given client country. An effective short-cut for Ontario firms in acquiring that knowledge can be to actively recruit people with a knowledge of foreign cultures.

While it does not appear that this source of advantage is being utilized to its full potential at present, the onus is predominantly on the private sector to recognize the benefits of doing more in this regard. The Government can play an information role, however, in drawing this opportunity to the attention of private sector firms.

It is therefore recommended:

18. That the Government seriously consider developing an information program to focus the attention of export-oriented firms on the benefits of drawing on our multi-cultural population as a source of expertise on the languages, business methods and relevant cultural differences of client countries.

5.) Foreign Students

Attracting foreign students to Ontario universities has benefits not only as a form of service trade in itself, but also as a means of enhancing Ontario's opportunities to export other goods and services.

In terms of direct service trade, it appears clear that the presence of foreign students is beneficial by virtue of the money they spend within the province. One study, by University of Windsor economics professor Reuben Green, found that the average foreign student at that university spends \$10,634 a year in Canada - and \$5,601 of this amount is spent off-campus on accommodation, food, clothing, and other incidentals.

Even more important, however, is the potential indirect trade benefit. Visa students tend to be concentrated in such fields of study as engineering, business, public administration, health care and computer sciences. It is reasonable to assume that by virtue of their education, many of these students will eventually have significant decision-making positions in their respective countries.

Particularly because the choice of service suppliers often is based on subjective factors such as trust and reputation, the contacts and the knowledge of the host country's capabilities obtained during those student years can be a powerful influence in subsequent decisions about the purchase of foreign expertise or goods. Thus, for instance, someone who has studied engineering in Ontario and is favorably impressed by our knowhow and firms, may be more predisposed to deal later with an Ontario consulting engineering firm than with, say, a European one.

This potential source of advantage can be reinforced by programs designed to develop close personal contacts between foreign students and leading Ontario firms in their field of study.

While it is very much in Ontario's interests to attract substantial numbers of foreign university students, however, we are actually moving in the opposite direction. Because of recent sharp increases in the differential tuition fees charged to foreign students, the enrollment of such students in Ontario universities is declining rapidly. Continuing such a policy of deliberately redirecting elsewhere the direct and even more important long-term benefits of educating foreign students would be short-sighted.

It is therefore recommended:

19. That, in view of the important role that educating foreign students can play in forging future trade links, the differential university tuition rates charged to such students be brought to levels competitive with other jurisdictions and sufficiently affordable to maintain a steady influx of such students into Ontario.

and

20. That the Government, in cooperation with the colleges and universities and the private sector, take the lead in developing a comprehensive program to establish close personal contact between foreign students and leading Ontario firms in their fields of study, and to ensure that these students can become fully acquainted with Ontario's export capacity relevant to those fields.

VII. ORGANIZATIONAL IMPLICATIONS

Any strategy can only be as effective as the instruments available for carrying it out. In the case of addressing the opportunities and challenges of our new economy, it is vitally important that there be effective structures and mechanisms to carry on the work begun by this study and to see to the implementation of necessary policies.

Such structures and mechanisms are needed for two basic reasons:

First, because we are still in a period of rapid and continuous change, the appropriate strategic response involves not a once-and-for-all policy but a process. We need a strong capacity to monitor and preferably even to anticipate developments, to identify needs and opportunities rapidly as they arise, and to coordinate responses across the broad range of government activities.

Second, because the adjustment of assumptions based on earlier economic circumstances is inevitably a slow and gradual process, it is important that responsibility for coordinating strategic responses to our new economic realities be specifically assigned within the government. In the absence of such assignment of responsibility, any strategic thrust might rapidly dissipate and be replaced by business-as-usual.

At present, jurisdiction over matters directly affecting the service sector is distributed among at least 16 ministries of the Government of Ontario:

Citizenship and Culture; Colleges and Universities; Community and Social Services; Consumer and Commercial Relations; Education; Financial Institutions; Health; Housing; Industry, Trade and Technology; Labour; Municipal Affairs; Northern Development and Mines; Skills Development; Tourism and Recreation; Transportation and Communications; Treasury and Economics.

Each of these ministries is able to deal with service sector matters within its particular sphere of responsibility. But as in the case of the proverbial three blind men who respectively grasped the trunk, the legs and the tail of an elephant and respectively concluded that an elephant resembles a snake, a tree and a rope, such a compartmentalized approach provides only limited potential for a comprehensive overview.

What does not yet exist is a strong institutional framework for focussing on the service sector as a whole in our economy, in the same specialized way as the agriculture and mines ministries deal with the primary sector and the Ministry of Industry, Trade and Technology (MITT) deals with manufacturing.

It should be noted that the Ministry of Industry, Trade and Technology - particularly through its activities in support of small business, and through its responsibility for the Ontario International Corporation - does play an important role with regard to the service sector. And the Office of Economic Policy of the Ministry of Treasury and Economics monitors developments in the service sector and makes policy recommendations.

But the predominant emphasis of the Ministry of Industry, Trade and Technology has historically been on the manufacturing industries, with service sector matters accorded only limited attention and resources within that manufacturing-oriented thrust. It is highly desirable that this ministry increase its efforts with regard to the service sector, as indeed it is already beginning to do. But broadening the ministry's institutional culture enough for the orientation to be fully even-handed between manufacturing and services would inevitably take considerable time and effort.

An even more important consideration is that, as a line ministry, MITT is not in an organizational position to coordinate the activities of other ministries that have an impact on the service sector. For this reason, even a substantial expansion of MITT's activities in support of the service sector - though it is highly desirable on its own merits - would not fully address the need.

The treasury ministry, as a central agency, does have some coordinating capacity. But because of its responsibilities for budgeting and fiscal control, Treasury often tends to play more of a proposal-reviewing than a policy-initiating role with regard to matters under the jurisdiction of line ministries.

A number of possible options for additional mechanisms have been examined by this study:

1.) A New Ministry

When a policy area is identified as deserving of greatly increased attention, it is a frequent practice for governments to highlight their concern by creating a new ministry. The creation of a Ministry of the Service Sector would, however, pose enormous practical difficulties.

Because the service sector encompasses so much of our economic and social policy activity, a new line ministry with direct responsibility for all or even most service sector matters would have to take over many of the activities of the 16 ministries listed above. That would create an administrative monster of unmanageable size and distort the entire structure of the Government.

Alternatively, it would be possible to retain the existing ministries and create a new ministry of state for the service sector, with a predominantly advisory and coordinating role. In the absence of direct jurisdiction or control over major program funds, however it is questionable whether such a ministry would have enough clout to justify its existence.

The creation of a specific service sector ministry does not appear at this time, consequently, to be an attractive option.

2.) Reinforcing the Center

Because addressing the opportunities and challenges of our new economy cuts so broadly across the range of government activities - encompassing not only the economic but also the social and education policy

realms - it is an undertaking that can most effectively be approached by engaging the energies of the government as a whole rather than merely of individual ministries.

The Premier, as chairman of Cabinet and leader of the Government, can play a vital role in this regard by sending a continuing signal as to the priority attached to this undertaking. And because virtually all ministries will have an important contribution to make, the most natural location for analysis and coordination work in support of this priority is in the Government's central mechanisms.

One way to do this would be to create a new position of special advisor to the Premier on the service sector, structured similarly to the recent positions of special advisor to the Premier on Crown corporations, and the existing position of Ontario representative to Quebec and the federal government. As is the case with these two positions, it would be appropriate for the special advisor on the service sector to function at the rank of deputy minister in order to be able to participate in the policy process at the highest levels. A small secretariat, attached to the Cabinet Office, could be established to support this position.

In conjunction with this approach, or as an alternative to it, a proactive role in directing the implementation of the kind of economic and social development strategy envisaged here could appropriately be entrusted to the Policy and Priorities Board of Cabinet. This would be consistent with the Board's general mandate to deal with strategic direction, long-range planning and cross-sectoral matters.

The special advisor's inputs could be referred to this board of ministers chaired by the Premier. If the position of special advisor were not created, alternatively, the resources of the secretariat which supports the board could be expanded as necessary to permit it to carry out the monitoring, analysis, coordination and policy recommendation functions outlined above.

It is therefore recommended:

21. That the Government build on the work of this study and provide an implementation mechanism by creating a position of special advisor to the Premier on the service sector, supported by an appropriate secretariat, to monitor and anticipate developments, to identify needs and opportunities as they arise, and to advise on coordinating policy responses across the broad range of government activities.

and/or

22. That the Government assign responsibility for such monitoring, policy development and coordination with regard to our economic transition to the Policy and Priorities Board of Cabinet, with appropriate enhanced support mechanisms.

3.) A Policy Analysis Institute

While the measures outlined above would strengthen the Government's capacity to respond quickly to opportunities and challenges, there would still remain a major gap in the resources available to the public policy process for identifying and understanding those opportunities and challenges.

As emphasized throughout this report, we are in the midst of a complex transition from industrial to "post-industrial" society that raises ongoing issues touching on virtually every aspect of our life as a community: economic policy and industrial strategy, social policy, the education system, the role of government and other institutions, and so on. Because of the unrelenting pressure of day-to-day demands, the direct mechanisms of government can at best have limited capacity to look pro-actively at these longer-term issues.

This natural limitation is evidenced by a proliferation of special task forces and studies to provide in-depth examination of issues that have been recognized as important. But such an ad hoc approach, while useful, also has its own limitations.

First, there is a certain fragmentation of analysis. As each special task force or study deals discretely with the issue it has been assigned, there is limited opportunity for an integrated approach that examines the various issues in relation to each other and in the context of their combined impact on our society.

And, second, there are inevitably time lags. Often a given problem or issue has already been in place long enough to assume considerable prominence before special analysis mechanisms are established. And then there is a second lag while a new task force gears up and establishes its own infrastructure.

These gaps in the Government's "early warning" and analysis mechanisms could beneficially be addressed by establishing a new arm's-length public policy analysis body, or think tank, as a successor to the Ontario Economic Council.

While the Government judged that the Economic Council was not making a sufficiently indispensable contribution to justify the costs of keeping it in operation, this does not negate the need for a different body with a mandate to inform and advise the Government and the public about the implications of the changes our society is undergoing.

The body envisaged here would be mandated to look at issues from the perspective of their combined social and economic implication, avoiding an overly narrow technical or economic focus.

To ensure continuity, an integrated approach to issues and an ability to respond quickly to emerging policy questions, this body would have a strong in-house research and analysis capacity rather than a heavy reliance on lengthy commissioned studies. It would supplement this capacity by contracting out such specialized work as necessary, or by setting up special temporary project teams.

Rather than functioning as a council, which risks having to take a "lowest common denominator" approach to its findings because of a need to achieve internal consensus among members representing different viewpoints, the envisaged body would be structured as an institute. Its role would be to put forward its best judgments based on the available data, leaving it to other mechanisms to assess those judgments and decide whether to seek consensus around them.

This body, which might be called the Ontario Institute for Social and Economic Development - or Ontario Development Institute, for short - would receive appropriate funding from the Government of Ontario to carry on its work. There could also be provision for generating a portion of the necessary operating revenues through activities such as organizing conferences, taking on special research projects, and so on.

The envisaged institute's mandate would permit it both to analyze and publicly report on issues selected by its own initiative, and to carry out policy studies requested by the Government. Consideration could also be given to having the institute provide centralized administrative and research support to any special task forces appointed by the Government.

It is therefore recommended:

23. That the Government establish a new public policy research and analysis institute, significantly different from the former Ontario Economic Council, with the mandate, funding and resources necessary to enable it to advise the Government and the public on emerging issues and opportunities from the combined perspectives of their economic and social implications.

PART TWO
THE CHALLENGE OF FREE TRADE

1.) High on the Agenda

While much of the public debate about a free trade agreement with the United States has focussed on the anticipated costs and benefits to manufacturing industries, it appears likely that any such agreement would have enormously important implications for our service sector.

Recognizing the importance that this sector has assumed in terms of employment and wealth creation, the U.S. Government now puts a very high priority on achieving international liberalization of trade in services. As Senior Assistant U.S. Trade Representative Geza Feketekuty put it in 1984: "Trade in services has risen in the hierarchy of U.S. trade policy objectives over the past few years, and it is now one of the top objectives."³⁸

In background discussions with senior U.S. trade officials in Washington as part of the work of this study, it was confirmed that this objective will be vigorously pursued in negotiations on a Canada-U.S. free trade agreement.

Apart from the interest of a number of major U.S. service sector industries in obtaining readier access to the Canadian market, it appears likely that an aggressive American approach in this sector will also be shaped by a broader international consideration: Whatever is negotiated bilaterally with Canada is seen as potentially setting a precedent, whether favorable or unfavorable, for U.S. efforts to obtain a multilateral easing of barriers to trade in services, particularly in the developing countries.

2.) Defining the Issue

While the issues vary from industry to industry, the principal trade barriers in the service sector are not tariffs but regulatory and legislative measures. Consequently, the focus of free trade negotiations is likely to include the following:

a.) Right of establishment - the right, for instance, of a U.S. investment dealer to set up operations in Canada, or vice versa. Because by their nature many services can only be exported by establishing a physical presence close to their purchasers, right of establishment is a much more important issue in services trade than in the case of goods which can be shipped across border.

b.) National treatment - that is, the treatment of U.S.-owned companies operating in Canada, and vice-versa, on exactly the same footing as domestically-owned ones. National treatment precludes special restrictions on the operations of foreign firms or special preferences - such as tax treatment or purchasing policies - for domestic ones.

c.) Regulatory harmonization - that is, the adjustment of regulations - even if they are applied on a "national treatment" basis - that are more restrictive in one country than the other and that therefore may function in effect as a non-tariff barrier.

d.) Mobility of Labor - that is, the ability of Americans in service sector fields that require a personal presence to freely enter Canada and operate here, and vice versa, without such restrictions as citizenship, licensing or work permit requirements or hiring quotas. This is particularly relevant in such professional fields as engineering, consulting, law and accounting.

3.) Winners and Losers

Strategic Consideration #9: Canada-U.S. free trade in services could be seriously disadvantageous for Ontario firms in banking; culture and broadcasting; the investment dealer industry; telecommunications; and transportation, while only some business services firms stand to gain significantly from enhanced access to the U.S. market.

Detailed work done for this study regarding the likely implications of free trade for the service sector leads to the following conclusions:

For a number of industries and industry groups, a free trade deal would likely have little direct or immediate impact, either because virtual free trade already exists or because trade issues play a comparatively small role. The industry groups and industries in this category are accommodation, food and beverages; retail trade; wholesale trade; education; health and social services; public administration and defence; construction; real estate operators; casualty and property insurance firms; insurance agencies; utilities.

At least five industries would be exposed to increased foreign competition without the prospect of sufficiently compensating benefits in the U.S.: Banking; culture and broadcasting; investment dealers; telecommunications; and transportation.

Two additional industries - trust companies, and life insurance firms - could be affected by a removal of current restrictions that prevent a takeover by foreign interests.

Only one industry group - business services - stands to gain significantly from increased access to the U.S. market, and even within this group some industries may lose while others gain.

It is appropriate, at this point, to focus in more detail on those components of our service sector on which free trade would likely have the greatest potential impact.

a.) Banking

Eight of the 12 Schedule A (that is, Canadian-owned) banks have their head offices in Ontario, though five of these are nominally headquartered elsewhere.

Foreign banks face a wide array of entry and operating restrictions in Canada.

The rules regarding entry include:

- Foreign banks are restricted to 16 per cent of domestic banking assets;
- They need authorization from the Minister of Finance to establish in Canada;
- Foreign bank subsidiaries must have their licenses renewed annually;
- Data processing and record keeping must take place in Canada.

Operating restrictions include:

- Foreign banks must be established in Canada to conduct banking business here;
- They must be established in a province to conduct trust and credit union business in that province;
- Foreign banks are not permitted to install automatic teller machines in Canada.
- Foreign bank subsidiaries need authorization from the Minister of Finance to open new branches.

While Canadian law strongly protects our domestic banking industry through this array of restrictions on foreign activities, the policy of the U.S. government already is one of "national treatment" for all foreign banks.

There are no restrictions in U.S. federal laws on the entry of foreign banks, and few differences between regulations governing domestic and foreign

banks. Conversely, under "national treatment" foreign banks are subject to the same restrictions as U.S. domestic banks.

Under a full free trade deal, consequently, the substantial establishment and operating restrictions on foreign banks in Canada would be removed, while Canadian banks could gain little in the already "open" U.S. market. Even though the major Canadian banks are large and powerful competitors, the result would likely be that over time a far larger proportion of Canadian banking activity than at present would be handled by subsidiaries of U.S. banks - and the possibility even exists that control of one or more currently Canadian-owned banks could be acquired by U.S. interests.

b.) Culture and Broadcasting

Ontario has the largest share of Canada's cultural services industry, and that industry is protected by a wide array of federal and Ontario measures. For instance:

- There are substantial federal and provincial subsidies and tax incentives to encourage production of Canadian films, television programs and books;
- Canadian content rules restrict the market for importation of broadcast programming and music;
- Canadian advertising expenditures in non-Canadian newspapers or periodicals aimed at Canadian audiences are not tax deductible as a business expense;
- There is a direct federal and provincial government involvement through such instruments as the Canadian Broadcasting Corporation, the National Film Board, Telefilm Canada and TV Ontario;
- To protect the rights of Canadian broadcasters who have bought the copyright to a U.S. program for the Canadian market, our cable companies are required to substitute Canadian commercials for American commercials when identical programs are broadcast simultaneously;

- Canadian magazines receive preferential postage rates;
- The Customs Tariff prohibits the importation of foreign magazines which contain more than five per cent advertising directed specifically at the Canadian market;
- Hiring preferences for Canadians exist in the performing arts.

While some governmental restrictions also exist in the U.S. - notably with regard to foreign ownership of broadcast media - the main entry barriers relate more to the strength of individual U.S. cultural industries which have dominance in the American market.

But access to the U.S. market is not, in any event, the principal concern in the Canadian cultural field. The primary importance of a society's cultural institutions lies not in their export potential but in their capacity to express and reinforce that society's distinct sense of identity. It appears clear, however, that we would be overwhelmingly the losers on both counts in any arrangement that removed governmental barriers on each side of the border. Our cultural institutions would be competitively swamped, while incremental Canadian penetration of the American market would be marginal at best.

Our domestic magazine, book publishing and broadcasting industries cannot compete effectively with Americans in the Canadian market because of the economies of scale enjoyed by the U.S. industries. It costs roughly the same to produce a similar book, issue of a magazine or hour of television programming in Canada and in the U.S. - but the market, and hence the return on the production outlay, is about 10 times as large in the U.S.

That is why, for instance, the customs tariff prohibiting importation of magazines with more than five per cent of advertising aimed at Canadians is absolutely vital. Without that measure, any American magazine with large Canadian circulation could easily do an extra press run for this country with the same editorial content - already paid for by its U.S. revenues - and take on Canadian advertising at a fraction of the rates our own magazines have to charge. Many Canadian magazines would be unable to survive in the face of that sort of cultural "dumping."

The same is true of the restriction of tax-deductibility to advertising placed in Canadian-owned media (Bill C-58). Without it, U.S. publications could imperil the viability of our domestic magazines by establishing "Canadian editions" with predominantly the same already-paid-for editorial content as the parent magazine, and offering advertising at rates which Canadian publications could not match.

Without Canadian content requirements, similarly, market forces would lead Canadian broadcasters to buy much cheaper "off the shelf" U.S. material instead of producing, or purchasing, original Canadian programming.

Each of our protective measures in the cultural field is founded in such competitive realities. And even with this array of measures, foreign penetration in our cultural industries is strikingly high. Foreign, mostly U.S., periodicals account for more than 70 per cent of newsstand sales; 75 per cent of books sold in Canada are foreign, mostly from the U.S.; 72 per cent of available program hours on English-language television are foreign, principally U.S.

It appears clear, consequently, that if any of the protective measures designed to maintain Canadian ownership and promote Canadian output were foregone in pursuit of free trade, our capacity to maintain distinct cultural institutions would be profoundly and irretrievably damaged.

c.) Investment Dealers

A majority of the head offices of Canadian investment dealers and a majority of securities industry jobs are located in Ontario.

While the rules regarding ownership in the securities industry are being relaxed by the Government of Ontario to address changing market conditions, foreign ownership in the Canadian securities industry remains restricted both in Ontario and in other provinces.

Under the new Ontario regulations announced this year and expected to come into effect in 1987:

- Non-residents will be limited to owning up to 30 per cent of a securities firm;

- Non-residents will be permitted to register as foreign securities dealers, but the total capital of all such foreign dealers will be limited to 30 per cent of the total industry capital and any one foreign dealer will be limited to 1.5 per cent of this capital;

Non-resident entrants will be required to meet defined standards of performance prior to being registered.

There are no similar restrictions in the United States. Entry as a dealer by an individual or company is regulated, but nationality is not a factor. Strong competition in the American industry, however, makes it difficult to become a major player regardless of nationality.

If restrictions on access to Canada's securities industry were negotiated away in a free trade deal, consequently, it does not appear that there is any potential for reciprocal gains in the U.S. market for Ontario-based firms. There is a real risk, however, that the Canadian industry would be overwhelmed by giant U.S.-owned firms if they were accorded unrestricted right of establishment and national treatment.

The magnitude of this risk can be seen from the fact that the 10 largest U.S. firms each have total capital exceeding that of the entire Canadian industry. The total capital of all Canadian firms in 1985 was \$778.9 million. The capitalization of the largest American firm, Merrill Lynch & Co., was U.S. \$2.2 billion. Four other firms had capital in excess of U.S. \$1 billion.³⁹

d.) Telecommunications

Ontario accounts for approximately one-third of Canada's telecommunications service activity and employment.

Access to the Canadian telecommunications market is barred by a system of regulated monopolies:

- Telecommunications companies such as Bell Canada, CNCP and Telesat are granted monopolies in their respective areas of activity;
- The Bell network (Telecom) has a monopoly on long distance service in Canada;
- Only one long distance international carrier exists in Canada - Teleglobe, which is a federal monopoly;
- Telecommunications services cannot be foreign-owned;
- CRTC regulations forbid the carrying of telecommunications traffic between two Canadian points via the U.S.;
- Rates are subject to approval by the CRTC.

The system in the U.S. differs significantly:

- Deregulation has permitted fierce competition among telecommunications carriers in the long-distance telephone market;
- While hundreds of small long distance companies compete in the U.S., AT&T has emerged with an 80 per cent share of the market, and three other companies - MCI, U.S. Sprint and ALC Communications - control most of the balance;
- Capital investment has been huge: MCI and U.S. Sprint alone invested more than \$2 billion in their networks in 1985;⁴⁰
- The AT&T divestiture resulted in regional companies which are considerably larger than Bell Canada: The revenues of seven companies in 1985 ranged from U.S. \$10.7 billion (Bell South) to U.S. \$7.8 billion (U.S. West), while Bell Canada's were U.S. \$4.8 billion.⁴¹

- Foreign ownership of telecommunications networks is strictly prohibited.

Under a free trade deal, there does not appear to be any great potential for Canadian firms to penetrate the U.S. market. On the other hand, telecommunications services in Canada would be subject to great competitive pressures and potential jeopardy.

At present, due to differing regulatory approaches and industry structures and an emphasis in this country on balancing local and long distance rates, domestic and international long distance and satellite rates are significantly higher in Canada than in the U.S.

If American firms were given access to the Canadian market, our own carriers would be subjected to extremely intense price competition. At best, this would require a major reduction of long distance rates, and a skyrocketing of rates for local service to compensate for lost revenues. The possibility also exists, if the price competition were too severe to meet, that a large volume of long-distance service between Canadian points would be routed via U.S. carriers, threatening the financial viability of our system and perhaps leading to the takeover of our firms by U.S. interests.

e.) Transportation

In general terms, the possibility exists that a free trade agreement could have a disruptive effect on our national transportation network by shifting the emphasis in transportation of freight from east-west to north-south. Such a shift could, over time, put into question the viability of our cross-country rail and shipping infrastructure.

In terms of the removal of existing trade barriers, freight rail service might suffer competitive problems because U.S. carriers have higher productivity levels and more experience in a deregulated setting, but the greatest impact would likely be in trucking and in air transportation.

i.) Trucking

Trucking is the largest component of the transportation industry in Ontario, accounting for 39 per cent of total revenues and a majority of jobs in this industry.⁴²

Subject to various restrictions, at present Canadian truckers can transport freight into the United States, and vice versa. But neither country permits foreign firms to provide service between two internal points unless they are specially licensed to do so. Apart from this restriction, however, Canadian truckers can operate with somewhat greater ease in the U.S. than can Americans here, because of the far more advanced state of deregulation south of the border.

If barriers were removed under a free trade agreement, a few large Ontario firms might be able to compete effectively, but on the whole U.S. firms would have considerable competitive advantage because of geographic factors and economies of scale. While some rationalization of the Canadian trucking industry appears inevitable in any event because of moves toward deregulation within this country, it appears questionable that the industry can withstand unrestricted U.S. competition without sustaining serious damage.

One of the reasons for this is the pattern of settlement in the two countries in relation to the border. Since our major population and industrial centres are located close to the border, Canadian cities could be easily serviced by U.S.-based carriers as extensions of American trucking networks. The converse is not true for Canadian truckers, since there is a far smaller share of the U.S. market within the distance range that a Canadian-based carrier can reach efficiently.

In addition, deregulation in the U.S. coupled with the size of the American market (there are 42 cities with population of more than 1 million, compared to three in Canada) has led to the emergence of a number of huge trucking firms with revenues in excess of \$1 billion and hundreds of terminals. Ontario firms would be hard-pressed to compete with the economies of scale enjoyed by such firms.

ii.) Air Services

At present, trade in air services is governed by bilateral agreements between Canada and the U.S. Our barriers are higher in the sense that we have a greater degree of regulation.

In freight air services, a free trade deal could place Canada at a competitive disadvantage because we have no specialized, dedicated air freight firms of the sort that exist in the U.S. Opening up the Canadian freight market, consequently, could cause our airlines to lose business and revenues to specialized U.S. firms.

In passenger services, Canada has large, competitive carriers and in theory they stand to gain more from access to inter-city routes within the huge U.S. market than do American firms from similar access to Canada. It is by no means certain, however, that in reality the results of free trade would be beneficial.

First, regulatory harmonization would likely require a degree of deregulation that would significantly change Canadian fare structures. Fares on the heavily travelled, commercially attractive routes would likely be reduced by competitive pressures. The resulting loss of revenues would make it impossible to continue cross-subsidizing service on routes that are less heavily travelled and lucrative - though no less important to those who rely on them - and rates on these routes would likely rise significantly and/or service would decline. Given the social and economic importance of an effective and affordable transportation network to a country as geographically far-flung as Canada, that could be a heavy price to pay.

Second, because U.S. carriers have more experience operating within a deregulated system and have adjusted their operations accordingly, Canadian airlines could be at a competitive disadvantage.

And, third, geography makes it feasible - as in the case of trucking - for major Canadian centers to be serviced by American carriers from U.S. bases as extensions of their routes. That is, our cities could be served by routes that were "spokes" from major airports or "hubs" in the U.S. Our airlines could not

as readily use Canadian cities as hubs for competition in the U.S. market, because our cities are located at the northern end of continental routes.

f.) Life Insurance Firms and Trust Companies

Canadian life insurance firms, which are predominantly based in Ontario, are world-class competitors and they already have substantial operations in the U.S.; the only significant restrictions are at the state level, in some states. Trust companies do not have an export orientation, so enhanced access to the U.S. market is not an issue.

In both these industries, however, unrestricted right of establishment in Canada under free trade could eventually result in substantial foreign ownership.

At present, federal law prevents foreign acquisition of life insurance firms already controlled by Canadians: No more than 10 per cent of the shares of such firms can be held by any one non-resident, and no more than 25 per cent of total shares can be held by non-residents. The same 10-25 rule applies to non-resident involvement in trust companies, under both federal and Ontario law.

With the elimination of this restriction under a free trade agreement, there is a real possibility that control of some trust companies and insurance firms could eventually be acquired by U.S. interests.

g.) Business Services

The broad "business services" category encompasses a great many distinct industries, ranging from engineering and law to employment agencies and computer services. These various industries fall into two basic groups: "professional" services - that is, industries such as engineering, law or accounting that are closely regulated by a government-mandated professional society - and "other" services.

In both Canada and the U.S., the regulations of the mandated professional societies form massive barriers to entry by outsiders. There is no way, for instance, for a foreign lawyer to practice in Canada. In the case of engineering, restrictions include a requirement that a foreign consulting engineer can only work in collaboration with a licensed local engineer.

In addition to such accreditation restrictions, however, the U.S. also imposes substantial entry barriers - not only in professional services, but also in other business service areas such as management consulting - through its immigration policies. Foreign consultants must apply for permits to enter the U.S., which at best entail delays and which are not necessarily granted. Similar entry barriers do not exist for consultants seeking to enter Canada.

A free trade agreement, consequently, would provide clear benefit for some industries in "other business services" - notably management consultants - by providing access to the U.S. market similar to the access American firms already enjoy to Canada.

Some other business services, however, would be likely to suffer as a result of "national treatment" requirements under free trade. The growth of our emerging computer software industry, for instance, could be significantly impeded if the Government were barred from supporting domestic firms through financial assistance measures or preferential procurement policies.

In the case of professional services, it is far less clear that free trade would result on the whole in a net benefit.

Ontario's largest consulting engineering firms, for instance, might benefit from enhanced access to the U.S. market. But by far the largest part of the industry in this province consists of small firms that are not geared to export activity: Some 800 of the approximately 900 consulting engineering firms in Ontario have 20 or fewer employees and fee revenues of less than \$1 million a year.⁴³

Far from gaining anything from free trade, these small specialized firms could find themselves competitively overwhelmed in the Ontario market by giant American firms. This risk is all the greater in view of the high degree

of foreign, principally American, ownership in our economy. In the absence of restrictions, a U.S. subsidiary requiring engineering services in Ontario might well be inclined to deal with the engineering firm that serves its parent company.

As the executive director of the Consulting Engineers of Ontario, William Weinstein, puts it: "Freer trade will assist only those firms with unique skills, but the majority may lose their local markets and lack the financial and human resources to compete with the United States consulting industry. This suggests that freer trade benefits will accrue to the large, financially powerful firms of both nationalities - a very small number of Canadians against a very large number of Americans."⁴⁴

Similar considerations apply in other professional fields such as law. In the absence of restrictions on foreign practitioners, it is not clear that there would be a large market for the services of Ontario lawyers in the U.S. But given the high proportion of American subsidiaries operating in Ontario, there might well be a tendency to import lawyers associated with the parent company and a resulting loss of business for our own firms.

h.) Other Industries

It was stated earlier that free trade would have little direct or immediate impact on a number of other service sector industries where virtual free trade already exists or where trade issues play a comparatively small role. But these qualifications are vitally important.

Indeed, one of the great risks of a comprehensive free trade agreement in the service sector is that it would deprive us of the freedom to respond to currently unforeseen contingencies.

The service sector is the most rapidly growing part of our economy and it is an area of extremely rapid change, with new industries springing into existence and with already-existing ones undergoing significant modifications. At the same time, we and other countries are just beginning to recognize the virtually unlimited potential for international trade and competition in services.

Under these circumstances, it is impossible to say with certainty that there will not be a future need for preferential assistance to help some new high-potential fledgling industry gain a foothold, or to protect some important Ontario industry from being overwhelmed by currently-unanticipated competitive techniques.

It would be very risky, consequently, to restrict our freedom of manoeuvre through a comprehensive free trade agreement that signed away our capacity to respond as necessary to future challenges and opportunities.

4.) Conclusions

On the basis of this industry-by-industry examination, it is difficult to see net benefit to Ontario in a free trade agreement regarding the service sector. This finding is consistent with the conclusions of the Royal Commission on the Economic Union and Development Prospects for Canada (Macdonald Commission) which stated:

"The removal of existing Canadian restrictions on the entry of U.S. firms in some (service) fields could result in significant penetration of Canadian markets by U.S.-based competitors without conferring comparable benefits in the other direction. Overall, it is likely that the United States has more to gain from the reciprocal reduction of barriers to trade in services than has Canada. For this reason, perhaps, Canada might reasonably expect that in return for its willingness to provide more open access to its services market, the United States might offer guarantees of improved access for goods exported from Canada."⁴⁵

Such a potential trade-off takes on a very different aspect, however, in the context of an understanding of our new economy: What would be involved in the Macdonald Commission's scenario - and potentially in the comprehensive deal being pursued by the federal government - would be trading off virtually certain losses in the sector of our economy that accounts for more than 70 per cent of employment and output, for the hope of uncertain and undemonstrated gains in the sector that accounts for some 20 per cent.

Moreover, the service sector industries that would be most open to adverse effects - financial services, culture, telecommunications, and transportation - are at the very heart of our economic and social infrastructure. Each of these industries has an importance far beyond its direct contribution to employment and output. The capacity to control our own financial affairs, the means to reflect and reinforce our distinct sense of identity, and the networks to transport communications, goods and people - these are some of the most strategically vital "commanding heights" of our economy, and each would be imperilled to one degree or another by free trade.

It is therefore recommended:

24. That, in view of the prospect of significant competitive and ownership losses in key service sector industries with only very limited compensating gains in others, the Government of Ontario be highly cautious regarding any comprehensive Canada-U.S. agreement for free trade in services.

and

25. That the Government of Ontario categorically reject and vigorously oppose any free trade agreement touching on the cultural industries, and/or any repeal or weakening of vital measures such as Bill C-58, the Customs Tariff restricting Canadian-aimed advertising in foreign publications, Canadian content requirements in broadcasting, and simultaneous substitution rules for cable television.

and

26. That, in view of the importance and growth potential of the service sector in our economy, the Government of Ontario not accept any free trade approach based on accepting losses in the service sector in exchange for potential gains in other sectors.

PART THREE:
SOME OTHER SERVICE SECTOR ISSUES
AND OPPORTUNITIES

I. THE POTENTIAL OF TOURISM

Strategic Consideration #10: Tourism is a key source of employment and output for Ontario's economy, and there remains great untapped potential for growth in tourism from overseas.

As detailed in the industry profile in the Background Papers of this report, tourism plays a vital role in the Ontario economy. It is estimated that the direct and indirect effects of tourism account for at least 9 per cent of total employment in this province and some 6 per cent of Gross Provincial Product.⁴⁶

Much of Ontario's success in attracting tourists from other provinces, the U.S. and overseas is attributable to the effective efforts of the Ministry of Tourism and Recreation. That success to date constitutes a solid foundation upon which we can, and should, seek to build further employment and revenue growth through additional initiatives.

1.) Overseas Tourism

The experience of the United States is instructive in this regard. In 1961, the year an aggressive "Visit USA" marketing program aimed at overseas was begun, only 13 per cent of foreign tourist business in the U.S. was from overseas; the remainder was trans-border, from Canada and Mexico. By 1971, the proportion of overseas tourism had increased to 20 per cent. Now more than 33 per cent of foreign visitors to the U.S. come from overseas.⁴⁷

In Canada, by contrast, only 5.0 per cent of foreign visitors in 1985 were from countries other than the U.S.⁴⁸

While the U.S. experience underscores the degree to which aggressive marketing can increase overseas tourism, the absolute numbers also suggest that Ontario is not yet getting its full potential share of the business.

The U.S. Department of Commerce reports that more than 9 million visitors a year come to that country from overseas. Other statistics indicate that more than 2 million of those visitors go to prime destination states within a short flying distance of Ontario - New York, Massachusetts, Illinois and Pennsylvania.⁴⁹ Considering that Ontario in 1985 attracted only an estimated 975,000 overseas visitors, it would appear that even just attracting more of the visitors already travelling to North American destinations near Ontario could significantly increase our tourism.

This would be highly desirable not only because of the potential for an increase in the total number of visitors, but also because overseas tourists have a much higher propensity to spend money once they are here than do visitors from other provinces or the U.S.

While visitors from countries other than the U.S. accounted for only an estimated 0.9 per cent of total person-trips in Ontario in 1985, they accounted for a disproportionately high 7.1 per cent of total tourist expenditures.⁵⁰

By contrast, visitors from the U.S. accounted for 21 per cent of total person-trips and 20.8 per cent of total expenditures. Travellers from other Canadian provinces accounted for 2.4 per cent of total person-trips and 7.7 per cent of total expenditures, while Ontarians travelling within the province accounted for 75.7 per cent of person-trips and 64.4 per cent of expenditures.⁵¹

At present, however, the Ministry of Tourism and Recreation's advertising and marketing efforts are directed predominantly at Ontarians and at the U.S. border states. These are identified as the key markets because Ontario and U.S. residents at present account for the vast majority of tourists and the greatest amounts of tourism expenditures.

While some limited marketing activities are undertaken overseas by Ontario - primarily through public relations activities including incentives to travel agents and participating in broadcast travel programs - image advertising aimed directly at consumers in overseas markets is left almost entirely to the federal government.

Under a rationalization of efforts between the federal and provincial governments, Ontario is now responsible for consumer tourism advertising within the province and within 350 miles of the U.S. border. The federal government directs its entire advertising expenditure at the U.S. market beyond 350 miles and at the overseas market.

This federal advertising is, of course, designed to boost awareness of Canada as a whole rather than specifically of Ontario. The image conveyed in the advertising reflects all parts of Canada, and under the current formula Ontario receives 2/12ths of total exposure.

There are two basic difficulties with this approach.

First, Canada's comparatively weak over-all performance in attracting foreign tourists suggests the need for promotional activities beyond what is currently being done.

Second, the country as a whole is so vast that comprehensive image advertising - depicting at once the West Coast, the Rockies, the Prairies, the attractions of Ontario and Quebec, and the Maritimes - can overwhelm the potential visitor seeking a destination for a one- or a two-week vacation. It seems quite possible that some overseas tourists might more readily be drawn here by consumer advertising that emphasized the diversity and quality of the urban and wilderness attractions available within a relatively small geographic radius in Ontario.

The need for an intensified promotional effort is also indicated by the fact that Ontario appears to be attracting a diminishing share of those overseas tourists who do come to Canada.

In 1976, 1977 and 1978, Ontario was the point of entry for just over 56 per cent of overseas visitors to Canada. This rose to a high of 58.4 per cent in 1980, then began declining. In 1984 and 1985, Ontario was the point of entry for only some 53 per cent of visitors.⁵²

While one might assume that this declining role as an entry point is due to an increase in visitors from the Orient, who might naturally be expected to enter via British Columbia, this is not in fact the case. Ontario's share of Japanese residents entering Canada has remained roughly constant, for instance, while our role as an entry point for residents of such European countries as West Germany, France and the Netherlands has diminished.

Against this background, the concentration of Ontario's marketing efforts overwhelmingly on those geographic areas that currently provide the most tourism - that is, Ontario itself and the U.S. - can perhaps best be regarded as having constituted the first phase of a two-phase approach. Now that strategies and programs for maximizing the potential of this most readily available market have been put in place, it is appropriate to begin devoting increased attention and resources to other areas of opportunity.

The desirability of a major campaign to attract more overseas visitors is not at all diminished by the fact that this market currently provides us with comparatively few tourists. On the contrary, given the size of the global tourism market and the success of the adjacent U.S. in attracting overseas visitors, our relatively weak performance is a strong argument for intensifying our efforts.

This argument can also be viewed in the context of a strong possibility that Ontario is currently spending less than is desirable on tourism marketing in the aggregate.

The Government's total expenditure on tourism advertising in 1986/87 will be approximately \$12.7 million. This represents a significant increase over the previous year. But because of the rapid escalation of media costs in Canada and the U.S. since the beginning of the decade, the 1986/87 expenditures will provide only some 60 per cent of the purchasing power of Ontario's advertising expenditures in 1981/82.

An increased effort to attract overseas tourists would likely require a net increase in the funds allocated for advertising. But given the importance of tourism as a source of employment and revenues, and the largely untapped potential of the overseas market, such an investment appears justified. There is no inherent reason why we should not be able to attract significantly more overseas visitors; but there is virtually no way we can hope to attract them without consumer advertising that focusses their attention on Ontario as a tourism destination.

Against this background, it is therefore recommended:

27. That, in recognition of the still largely untapped potential for generating additional employment and revenues through increased tourism from countries outside North America, the Government undertake a significant overseas advertising and marketing initiative.

2.) Tourism Development Priorities

The activities of the Government in support of tourism fall into three broad categories: marketing; assisting the development of major travel generators in the form of large destination resorts and major tourist attractions; assisting small accommodations and attractions.

While a mix of all three types of support is necessary, it appears that marketing and development of major travel generators have the greatest potential for attracting additional tourists. If and as incremental funds are made available for tourism development, it would make sense for these activities to get priority.

It would not be realistic to recommend a shift of existing resources away from assistance to operators of small accommodations and attractions, however, for at least two reasons.

First, that assistance - in the form of loans, loan guarantees and interest rate subsidies - fills an important gap. Because they are regarded as a marginally profitable, high-risk, seasonal industry, small tourism operations have difficulty obtaining funds for expansion or upgrading from banks or other conventional sources.

Second, the net cost to Ontario of this type of assistance is relatively low. For instance, the largest program, TRIP (Tourism Redevelopment Incentive Program), provides loan guarantees with interest subsidy. The outstanding balance of loans guaranteed under this program as of March 31, 1986, was \$49.7 million. But the actual cost to Ontario of TRIP for 1986/87 is estimated at \$5.6 million, of which approximately \$4 million represents interest subsidies and \$1.5 million represents the costs of honoring loan guarantees. Thus, the amount of money that could be redirected to other tourism priorities by reducing the scope of this sort of program is relatively small, while the negative impact on small operators would be considerable.

3.) Hospitality Awareness

While it is vital to attract tourists to Ontario through effective marketing, that is only a first step. Whether they return for a second visit -and whether they advise others to travel to this province or to stay away -depends on how they feel treated once they are here.

In part, that depends on the quality of service in hotels, restaurants and other tourist destinations. That quality, in turn, largely depends on the level of training and professionalism of the service providers. In that regard, the establishment of a new Canadian Tourism Management Center at Georgian College in Barrie will be an important step forward.

Another important consideration for overseas tourists is the availability of basic services in their own languages. Ontario has considerable potential for improvement in this area. At present, visitors who speak languages other than English or French have considerable difficulty finding restaurant menus, tours and brochures at attractions, hotel laundry lists, and so on in their own language.

One way to start addressing this gap would be for the Government to develop a summer student program in which language students and other multilingual young people would be employed as tour guides at provincial attractions and as translators of menus, brochures, etc. submitted by private operators.

Apart from such specific opportunities, it is also desirable to ensure that Ontarians in general are aware of the importance of tourism to our economy and of the importance that a hospitable atmosphere plays in attracting such tourism. It would be helpful, consequently, for the Government to develop a hospitality awareness campaign, emphasizing the theme that tourism means jobs.

It is therefore recommended:

28. That the Government consider developing a hospitality awareness campaign, emphasizing to the general public the importance of tourism, and to tourism operators the importance of such amenities as multilingual menus and brochures.

and

29. That the Government consider establishing a summer student program to provide multilingual guide services at provincial attractions and to translate menus, brochures, etc. submitted by private sector operators.

II. THE FINANCIAL INSTITUTIONS

Policy decisions regarding ownership and regulation issues in the financial industries have already been announced by the Government of Ontario.

This report will confine itself, consequently, to the still-unresolved issue of International Banking Centers.

In the February 26, 1986 Budget Speech, the federal government announced its intention to designate Montreal and Vancouver as International Banking Centers (IBCs).

Despite repeated expressions of grave concern by the Government of Ontario, the City of Toronto and members of the Ontario business community about this approach, the federal government apparently has not yet been persuaded to reconsider this approach.

It would be highly unfortunate, however, if this initiative were actually implemented.

The joint federal-provincial designation of individual cities as IBCs, with special tax incentives intended to attract international banking activity, is a technique of highly questionable merit. As a study by former Bank of Canada Governor Louis Rasminsky and William Lawson - commissioned by the federal government itself - warned last spring, this approach may generate little incremental wealth or employment. Instead, it may only cause taxation revenue losses by encouraging the transfer of banking activities currently booked in Canada.

A far more fundamental concern, however, is that it would be absurd, and potentially highly damaging, to federally designate Montreal and Vancouver as International Banking Centers, while denying the same designation to Toronto.

Toronto is indisputably Canada's financial center, and the center of both domestic and international banking activity. The five largest chartered

banks all conduct their international operations from Toronto, and 44 of the 56 foreign bank subsidiaries established in Canada have their headquarters in this city.

If the federal government nevertheless designates Montreal but not Toronto, it is difficult to see how this could be perceived as anything other than an attempt to siphon existing banking activity out of Toronto and to indicate a federal preference that any new international banking activities be based elsewhere.

Such a perception in international financial circles, whether accurate or not, could be enormously damaging to the Toronto and Ontario economies. By establishing itself as Canada's financial center through years of effort, Toronto has developed a basis for attracting not only new financial activities but also other businesses that want to be close to those activities. This basis for employment and output growth would be seriously imperilled if an impression were created that a deliberate national policy decision has been made to encourage financial businesses to locate elsewhere.

It appears highly noteworthy that the federal government has offered no rationale or explanation for its intention to designate other cities but not Toronto. In the absence of such clarification, it is difficult in the extreme to conceive of any sound economic justification for a move that flies in the face of current market realities. The initiative can more readily be perceived as political in nature, motivated by considerations upon which it is beyond the mandate of this study to speculate.

Whatever reasoning underlies this initiative, however, it is difficult to see how a policy likely by its very nature to inflict unfair economic damage on a city and its people can be reconciled with the role of a national government in providing equitable and even-handed leadership for all Canadians.

In view of the potential damage to the Toronto and Ontario economies, it is appropriate for the Ontario Government to continue pressing its insistence that Toronto be included in any federal designation of cities as international banking centers. And to the extent that the federal initiative

appears political in nature, the best hope of dissuading the federal government from this course may also lie in the political arena - that is, in ensuring that the people of Ontario are made fully aware of the threat that this contemplated action by the current federal government poses for our economic wellbeing.

It is therefore recommended:

30. That, in view of the serious damage that would result to Ontario's economy from a perception that federal policy encourages a shift of financial activity away from Toronto, the Government continue to vigorously pursue the inclusion of Toronto in any federal designation of Canadian cities as International Banking Centers.

III. SHOWCASING ONTARIO DESIGN

Ontario's design industries - industrial, interior, graphic and fashion - have an economic importance beyond their direct contribution to employment and output.

These industries, profiled in the Background Papers of this report, can significantly enhance the competitiveness of other Ontario exports.

Industrial design plays a vital role in giving form to products. For instance, a 1978 report prepared for the federal government on Canadian furniture industry exports concluded: "All available data in this study and in previous studies confirm the overwhelming importance of design in the sale of furniture. This holds true at all price levels and for virtually all segments of the industry, from lamps to office furniture."⁵³

Similarly, a British government study reported: "An analysis of the different factors affecting the export of West German goods for the United States revealed that 47 per cent were design-related compared to only 28 per cent for price. This message was reinforced by a study of the reasons why British manufacturers bought foreign machine tools, which attributed 51 per cent to design and only five per cent to price."⁵⁴

Interior design firms create markets for export of Ontario-manufactured goods when they take on projects abroad. Because they make procurement decisions based on products and suppliers they already know, our interior designers often specify a broad range of Canadian goods including furniture, light fixtures, wall materials, draperies, showcases, display racks, and so on.

When Ontario firm Rice Brydone Ltd. designed the new interiors of the New York Stock Exchange, for instance, some 75 per cent of the procurement - including all the furniture - was from Canada.

Fashion design makes a major contribution to the export potential of our garment industry, while graphic design can provide a competitive edge by helping to position firms and products clearly and distinctively in the marketplace.

There is intense international competition in all fields of design, and the key to success is world-class excellence.

A number of opportunities exist for the Government to help develop that excellence, and to focus attention on it where it already exists. Such initiatives would be particularly timely, because the federal government's recent winding down of the National Design Council and of the associated Design Canada within the Department of Regional Industrial Expansion has left significant gaps in the support available to the design industry.

1.) Design Scholarships

To be on the leading edge of international design, it is important for our most promising young designers to have the opportunity to pursue post-graduate studies at leading centers in Europe and in the U.S.

For this reason, the now-defunct Design Canada ran a scholarship program which enabled about a dozen young industrial designers a year - five or six of them Ontario residents - to undertake post-graduate studies in countries such as Britain, Switzerland, Italy and the U.S. Most of the leading figures in today's Canadian design community studied on these scholarships. Since tuition fees alone for post-graduate studies in these countries run as high as \$10,000 a year, the loss of the scholarship program can make foreign study financially prohibitive.

The opportunity for foreign study is similarly important in the other design industries. Indeed, the Association of Registered Interior Designers of Ontario has established a foundation which offers scholarships to promising interior design students, but this scholarship program is still small and under-financed.

It is therefore recommended:

31. That, in order to assist Ontario's most promising young designers in developing world-class excellence, the Government in cooperation with the respective design industries establish a scholarship program for post-graduate foreign studies in each of the fields of design.

2.) Design Awards

Awards for outstanding design can play an important role not only in setting a standard of excellence, but also in drawing the attention of the marketplace - both domestic and foreign - to some of our most talented practitioners.

Since the demise of Design Canada, there is no comprehensive program of awards to which Ontario's designers can aspire. The establishment of an annual Ontario award for excellence in design in each of the fields is strongly favored by the industry, and the idea appears to have considerable merit.

It is therefore recommended:

32. That the Government, in cooperation with the industry, establish a program of annual Ontario awards for excellence in each of the fields of design.

3.) A Design Center

The Olympia & York real estate development firm has proposed establishing a Design Center in the old Toronto Stock Exchange Building. Whether or not this particular location proves feasible, the concept of establishing such a center has considerable merit.

The establishment of this center is being advocated by a committee that includes prominent representatives of the industrial, interior and graphic design industries as well as members of the academic community. What is envisaged would be an exhibition and educational center of design in the broadest sense, including interior design, industrial and product design, applied arts, architecture, fashion, graphics and urban design.

By providing a showcase for design, such a center could help develop a broader appreciation of design excellence in Canada and encourage industries to enhance their international competitiveness by making better use of design expertise.

It is therefore recommended:

33. That, in order to provide a showcase for excellence and broaden awareness of design's potential contribution to competitiveness, the Government support and facilitate the establishment of a major Design Center.

SUMMARY OF STRATEGIC CONSIDERATIONS

1. Manufacturing will remain vital as a source of output and wealth creation, but we can no longer look to this sector as a major source of future new employment.
2. Our best hope for competitive advantage in international trade lies not in the mass production of goods, but in the specialized application of knowledge.
3. In our new economy, comparative advantage is not static but dynamic - that is, it can be created by appropriate strategies.
4. In the previous industrial economy, the most important inputs were capital and raw materials; in the emerging new economy, the most important inputs are people and knowledge.
5. To compete effectively in a new knowledge-intensive global economy that relies primarily on human capital, excellence in educating our work force is our single most important strategic weapon.
6. By far the most important engines of employment growth in our new economy are not large corporations but small businesses in the service sector, and particularly new small business start-ups.

7. In an economy where people are the most important asset, a strong network of social support measures is not a financial drain but a vital instrument of economic development.
8. Virtually every type of service is potentially exportable, and global trade in services may eventually outpace trade in goods.
9. Canada-U.S. free trade in services could be seriously disadvantageous for Ontario firms in banking; culture and broadcasting; the investment dealer industry; telecommunications; and transportation, while only some business services firms stand to gain significantly from enhanced access to the U.S. market.
10. Tourism is a key source of employment and output for Ontario's economy, and there remains great untapped potential for growth in tourism from overseas.

SUMMARY OF RECOMMENDATIONS

1. That all future economic development policies such as tax measures, industrial assistance, and export promotion initiatives be considered by the Government of Ontario in a context that fully recognizes the importance of the service sector to our economy.

2. That the Government of Ontario, in cooperation with school boards across the province, put high priority on curriculum development and other appropriate measures to ensure that by high school graduation all students have full proficiency in "basic" skills - reading comprehension; coherent writing with sound spelling and grammar; mathematics; computer familiarity; and some understanding of science - as well as specific training in clear thinking and effective learning.

3. That, as a means of ensuring that all students acquire proficiency in the basic academic skills, the Government of Ontario seriously consider instituting standardized province-wide testing in those skills at appropriate intervals during the primary and secondary school years.

4. That funding for universities be substantially increased, in the context of a cooperative effort between the universities and the Government, and among the universities themselves, to reduce needless duplication of effort and to channel incremental funds toward the building up of centers of excellence within each university.

5. That Ontario colleges and universities place major emphasis on developing students' communication, problem-solving and decision-making skills in all fields of study, with an integrated inter-disciplinary approach whenever possible.
6. That, to produce the boundary-spanning expertise needed in some areas of our economy, Ontario universities intensify efforts to develop special programs of combined study in such fields as marketing and engineering.
7. That the Government take the lead in discussions with Ontario universities to establish a world-class center or institute for the study of international trade and marketing associated with one of the existing business schools and with access to related teaching of foreign languages, and that the Government ensure the availability of the necessary funding for such a center or institute.
8. That the Government continue and further reinforce its support for co-op education programs, working in cooperation with school boards and the business community toward ensuring the availability of a full co-op program in every Ontario high school.
9. That, in order to strengthen the viability and growth potential of small service sector firms, the Government of Ontario facilitate their access to equity capital by extending eligibility for the Small Business Development Corporation program first to all incorporated business services not yet eligible, and then gradually to other service sector industries.
10. That the Government seriously consider making severance payments and withdrawn accumulated pension funds exempt from income tax if they are invested in a new business owned by the recipient.

11. That the Government improve the vital access of small business operators to information and to assistance programs by establishing a comprehensive network of small information centers located in every Ontario municipality with a business community large enough to support one.
12. That the Government seek to provide small businesses with a "one-stop" source of services in merchant banking, financial planning, management and marketing counselling, training and provision of information, for example by exploring with the federal government the possibility of Ontario taking over all activities in this province of the Federal Business Development Bank other than the existing loan portfolio, and integrating them with the activities of the Ontario Development Corporation and the two regional development corporations.
13. That the Government establish a large-scale, province-wide and high-profile volunteer program of small business counselling services drawing on the expertise of retired executives and entrepreneurs -assisted as needed by business professors, government experts and management consultants - to supplement the federal CASE program and to integrate with it in the event that the ODC and the FBDB are merged.
14. That, to strengthen our competitiveness and capacity for adjustment in a changing economy, maintaining and expanding our network of social support measures - including financial assistance, health care, subsidized housing, counselling, day care for children, and care and services for the elderly - be regarded as a high-priority investment in nurturing our human resources and in creating employment.
15. That our income distribution mechanisms, including our tax system, be reviewed to ensure ability to help fund the expansion of these social support measures by obtaining for society a fair share of the profits from the application of labor-displacing technologies.

16. That a specialized agency of the Government, dedicated exclusively to the promotion of trade in services and related goods, be given the mandate and the resources to:

- carry out an ongoing and highly sophisticated market intelligence function to identify potential customers for Ontario service exports, with particular emphasis on newly-industrializing countries, and convey the information to potential exporters;
- maintain a detailed, up-to-date inventory of service export potential in both our private sector and within the Ontario government, and identify potential private- and public-sector linkages as well as linkages with the export of manufactured goods;
- promote Ontario's service-exporting capacity through trade missions, publications, advertising, etc., as well as through support and assistance for pursuit of specific deals by Ontario firms;
- serve as a central marketing agency for all service exports by the Ontario government;
- where appropriate, initiate the assembly of packages that combine government expertise with private sector services and/or goods, and market or assist in marketing those packages;
- where appropriate, take the lead in assisting the formation of consortia of small private sector firms to provide a service that these firms would be unable to export individually;
- in instances where direct government-to-government deals provide a competitive advantage, take a role as prime contractor on behalf of qualified private sector companies, subject to appropriate performance guarantees; and
- provide advice to Ontario service exporters on the structuring of financing packages for potential deals.

17. That, in order to assist Ontario firms in attaining the size and experience desirable to compete effectively in international markets, the Government pursue a policy of contracting out as much as possible of its professional and technical work to qualified private sector firms, and that preference in this regard be given to Canadian-owned enterprises because of the greater likelihood that they will develop an export orientation.
18. That the Government seriously consider developing an information program to focus the attention of export-oriented firms on the benefits of drawing on our multi-cultural population as a source of expertise on the languages, business methods and relevant cultural differences of client countries.
19. That, in view of the important role that educating foreign students can play in forging future trade links, the differential university tuition rates charged to such students be brought to levels competitive with other jurisdictions and sufficiently affordable to maintain a steady influx of such students into Ontario.
20. That the Government, in cooperation with the colleges and universities and the private sector, take the lead in developing a comprehensive program to establish close personal contact between foreign students and leading Ontario firms in their fields of study, and to ensure that these students can become fully acquainted with Ontario's export capacity relevant to those fields.

21. That the Government build on the work of this study and provide an implementation mechanism by creating a position of special advisor to the Premier on the service sector, supported by an appropriate secretariat, to monitor and anticipate developments, to identify needs and opportunities as they arise, and to advise on coordinating policy responses across the broad range of government activities.

and/or

22. That the Government assign responsibility for such monitoring, policy development and coordination with regard to our economic transition to the Policy and Priorities Board of Cabinet, with appropriate enhanced support mechanisms.

23. That the Government establish a new public policy research and analysis institute, significantly different from the former Ontario Economic Council, with the mandate, funding and resources necessary to enable it to advise the Government and the public on emerging issues and opportunities from the combined perspectives of their economic and social implications.

24. That, in view of the prospect of significant competitive and ownership losses in key service sector industries with only very limited compensating gains in others, the Government of Ontario be highly cautious regarding any comprehensive Canada-U.S. agreement for free trade in services.

25. That the Government of Ontario categorically reject and vigorously oppose any free trade agreement touching on the cultural industries, and/or any repeal or weakening of vital measures such as Bill C-58, the Customs Tariff restricting Canadian-aimed advertising in foreign publications, Canadian content requirements in broadcasting, and simultaneous substitution rules for cable television.

26. That, in view of the importance and growth potential of the service sector in our economy, the Government of Ontario not accept any free trade approach based on accepting losses in the service sector in exchange for potential gains in other sectors.
27. That, in recognition of the still largely untapped potential for generating additional employment and revenues through increased tourism from countries outside North America, the Government undertake a significant overseas advertising and marketing initiative.
28. That the Government consider developing a hospitality awareness campaign, emphasizing to the general public the importance of tourism, and to tourism operators the importance of such amenities as multilingual menus and brochures.
29. That the Government consider establishing a summer student program to provide multilingual guide services at provincial attractions and to translate menus, brochures, etc. submitted by private sector operators.
30. That, in view of the serious damage that would result to Ontario's economy from a perception that federal policy encourages a shift of financial activity away from Toronto, the Government continue to vigorously pursue the inclusion of Toronto in any federal designation of Canadian cities as International Banking Centers.
31. That, in order to assist Ontario's most promising young designers in developing world-class excellence, the Government in cooperation with the respective design industries establish a scholarship program for post-graduate foreign studies in each of the fields of design.

32. That the Government, in cooperation with the industry, establish a program of annual Ontario awards for excellence in each of the fields of design.

33. That, in order to provide a showcase for excellence and broaden awareness of design's potential contribution to competitiveness, the Government support and facilitate the establishment of a major Design Center.

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APPENDIX

Background Notes on the Service Sector in Ontario

Ministry of Treasury and Economics
May 1986

March 13, 1986

The Honourable Robert Nixon,
Treasurer of Ontario,
Queen's Park,
Toronto.

Dear Mr. Nixon:

On October 15, 1985, I was asked to undertake a study of the service sector in Ontario, and to report the findings to you within a year. My understanding of the study's mandate is the following:

- To identify the significance of the service sector to Ontario's economy;
- To establish where growth has been occurring within this sector, where it is likely to occur on the basis of current trends, and where it might be encouraged to occur by the application of appropriate government policies;
- To examine what other jurisdictions, both within Canada and abroad, are currently doing or are likely to do to support their respective service sectors;
- To assess the efficacy of existing public policy measures and structures dealing with the service sector;
- On the basis of the above findings, to present policy options for consideration by the Ontario government to support growth of the service sector in terms of jobs and/or wealth creation, with special emphasis on action to enhance the export of Ontario services.

Considerable analysis has been completed to date on the study and I am pleased to provide this interim report for consideration.

Yours sincerely,

George Radwanski

Background Notes on the Service Sector in Ontario

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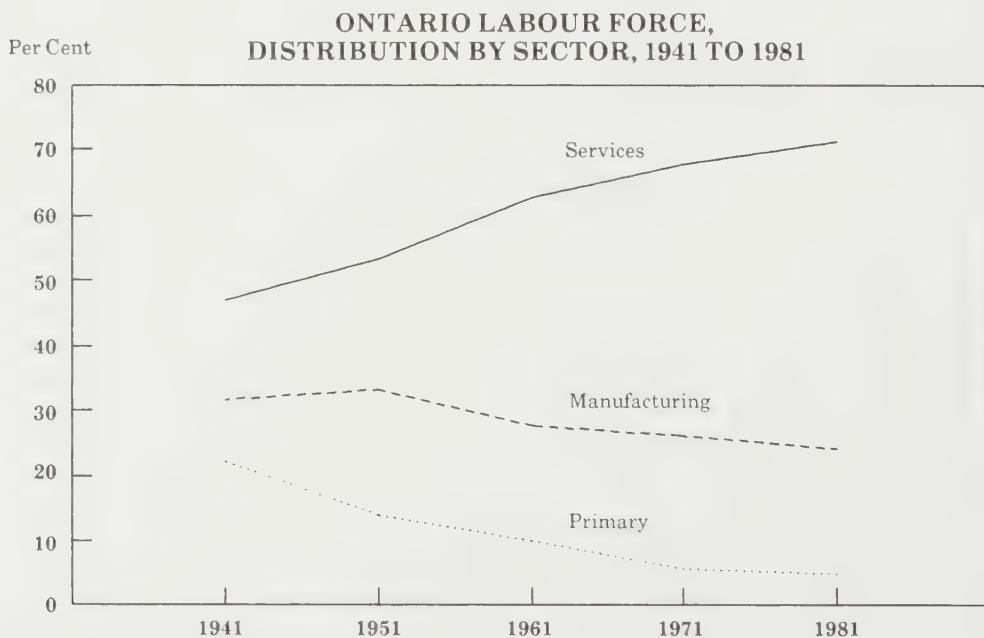
Introduction

The service sector is by far the largest component of Ontario's economy in terms of employment and Gross Provincial Product. It has also exhibited the fastest growth rate as a sector, and is the largest employer of women in the Ontario economy.

It is, therefore, timely to look at the service sector in greater detail. The following are some of the preliminary findings of a study initiated in October, 1985. (For sources of all reference material, please see the Appendix.)

Scope of Service Sector

1. The service sector in Ontario now accounts for 73 per cent of employment¹ and 70.2 per cent of Gross Domestic Product.²
2. This emergence of the service sector as the largest component of our economy is the key element of a socio-economic transformation as fundamental as the earlier transition from agrarian to industrial economies. This transformation, widely described as the emergence of a "post-industrial" society, is occurring not only in Ontario but also in Canada as a whole and in more than a dozen other advanced industrialized countries. In Canada, the service sector accounts for 75.6 per cent of employment³ and 72.4 per cent of Gross Domestic Product.⁴ In the U.S., it accounts for 76.8 per cent of employment and 73.3 per cent of Gross Domestic Product.⁵
3. The service sector absorbed 84.6 per cent of the total labour force growth in Ontario between 1941 and 1981.⁶ According to the Ontario Task Force on Employment and New Technology (1985), 80 per cent of all new jobs created in Ontario over the next decade will be in the service sector.
4. This growth of the service sector is not a new or sudden phenomenon. Rather, it has been a steady progression over decades. In 1941, 46.8 per cent of Ontario's labour force was in the service sector; in 1951, 53.2 per cent; in 1961, 62.6 per cent; in 1971, 67.9 per cent; and in 1981, 71.6 per cent.⁷



Source: Statistics Canada, Census Data.

5. The service sector is by far the largest source of employment for women in Ontario, accounting for 82.4 per cent of all the province's

employed women.⁸ Within the service sector, 49.1 per cent of employees are female, compared to 43.5 per cent in the Ontario economy as a whole. In manufacturing, only 28.7 per cent of employees are female, and in the primary sector only 25.8 per cent.⁹

6. This emergence of the service sector as the largest component of our economy appears irreversible. Consequently, it is not useful to debate whether the shift to a "service economy" is desirable; it is already an inescapable fact of life.
7. The issue is not, however, one of services versus manufacturing. The manufacturing sector is, and will remain, a vitally important generator of wealth in our economy. Far from being competitive with each other, the goods-producing and service sectors are fundamentally complementary. A balanced public policy would ensure that each sector is given the support necessary to enable it to live up to its full potential.

Reasons for Closer Study

8. It makes good sense to look very closely at the economic sector that provides a livelihood for three out of four employed Ontarians -- a total of 3,214,000 service-sector employees.¹⁰
9. More specifically, it is appropriate to intensify attention to the service sector for the following reasons:
 - It has been estimated that 80 per cent of new jobs in Ontario over the next decade will be in this sector, but it is by no means assured that this sector would live up to its full potential to produce jobs -- in particular, high-quality jobs -- and wealth, in the absence of supportive public policy.
 - It would not be possible to understand fully the broader socio-economic transformation often described as the emergence of a "post-industrial" society without coming to grips with the role played by the service sector.
 - The growing internationalization of services and the growing global trade in services present both opportunities and competitive risks which must be understood in order to be appropriately addressed.
 - The competitiveness of our manufacturing sector in the world economy will depend to a considerable extent on its access to support from an efficient and innovative service sector.
 - Other jurisdictions -- notably the United States, Britain and Japan -- have begun a major push on service sector issues. We risk being at a disadvantage if our own understanding in this area does not catch up and keep pace.

Definition of Service Sector

10. A first step in understanding the service sector is focussing on what it encompasses. There is, unfortunately, no universally accepted definition of what constitutes this sector.

Some attempts at definition focus on the "intangibility" of services. In this view, a service is something that is of economic value but that cannot be physically touched or handled. But this can be misleading and confusing. Not everything of economic value that is intangible -- for example business reputation or "good-will" -- is actually a service. And not every service is readily perceived as intangible; for example books, videocassettes and credit cards. (Each of these is actually a service embodied in a good; the bulk of the value is respectively in the literary content, the recorded entertainment and the facilitation of financial transactions, rather than in the paper, celluloid or plastic.)

Other definitions use the "residual" approach: whatever cannot be readily categorized as part of the primary or manufacturing sectors is regarded as part of the service sector. But even here, there are disagreements: some "residual" definitions exclude construction and/or utilities from the service sector.

11. For public policy purposes, the most useful -- and least contentious -- definition to use is the "residual" approach in its broadest form. Construction and utilities are included in the service sector because they do not fit satisfactorily into either the primary or manufacturing sectors and would not readily tend to respond to broad initiatives aimed at either of those sectors.

Accordingly, the service sector in Ontario is defined in this study as comprising all economic activity other than agriculture; forestry; fishing, hunting and trapping; oil wells, mines, and quarries; and manufacturing. (Services ancillary to these activities -- for example services to agriculture -- are considered part of the service sector.)

12. Specifically, the service sector in Ontario encompasses more than 100 distinct types of activity grouped by Statistics Canada into six broad divisions: construction; transportation, communication and other utilities; trade; finance, insurance and real estate; community, business and personal services; and public administration and defence.

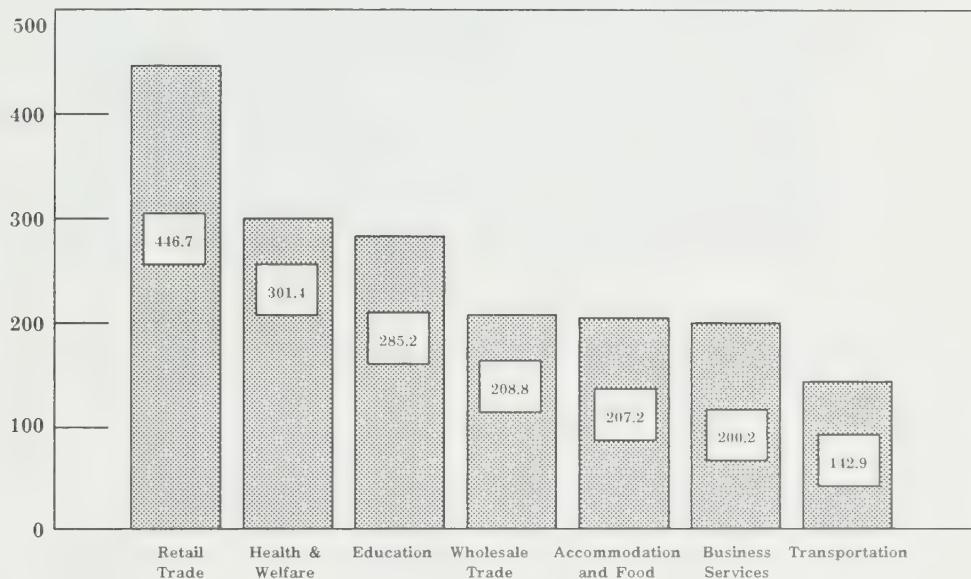
Largest Components of Service Sector

13. In Ontario, the seven largest service sector major industry groupings in terms of employment (1985) are:¹¹
 - retail trade;
 - health and welfare services;

- education and related services;
- wholesale trade;
- accommodation and food;
- services to business management; and
- transportation.

Thousands of Employees

ONTARIO'S LEADING SOURCES OF SERVICE SECTOR EMPLOYMENT BY MAJOR INDUSTRY GROUPINGS, 1985



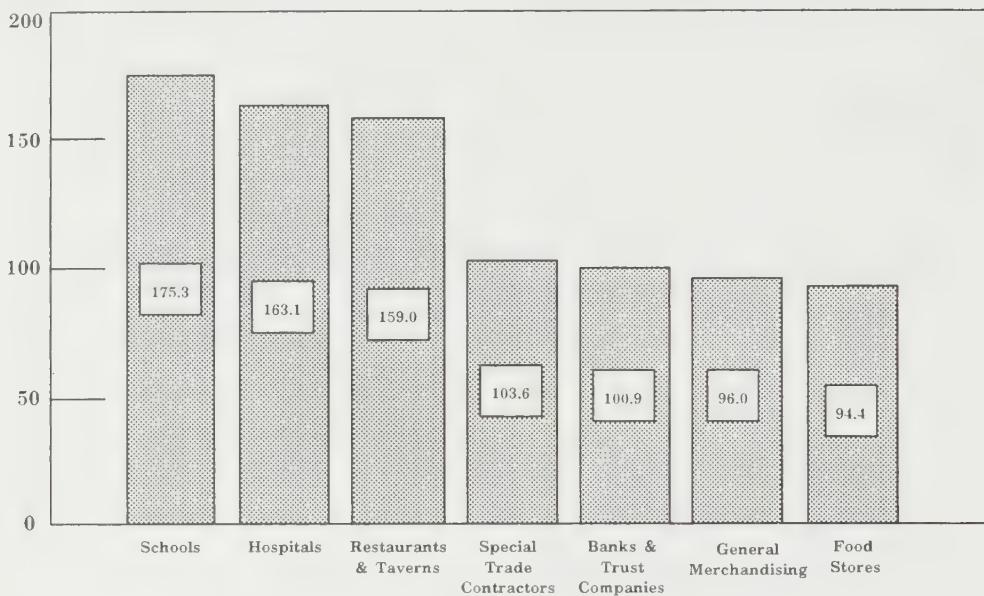
Source: Statistics Canada, CANSIM, Matrix 8363 (Survey of Employment, Payrolls & Hours), March, 1986.

14. At a more detailed level, the largest specific industries (excluding public administration and defence) in the Ontario service sector in terms of employment are:¹²

- elementary and secondary schools;
- hospitals;
- restaurants, caterers and taverns;
- special trade construction contractors;
- banks and other deposit-accepting establishments;
- general merchandise stores; and
- food stores.

Thousands
of
Employees

**ONTARIO'S LEADING SOURCES OF SERVICE
SECTOR EMPLOYMENT BY DETAILED INDUSTRY, 1985**



Source: Statistics Canada, CANSIM, Matrix 8363 (Survey of Employment, Payrolls & Hours), March, 1986.

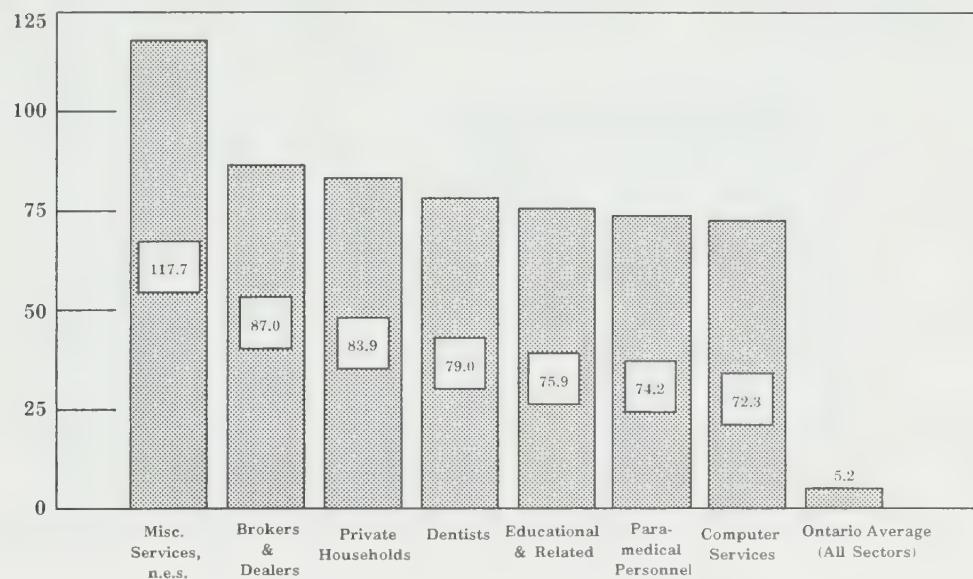
Strongest Growth Areas

15. Currently the fastest-growing individual industries in the Ontario service sector, in terms of rate of increase in employment between 1978 and 1983 (measured in "full-year equivalent" jobs) are:¹³

- miscellaneous services, not elsewhere specified (for example: translating services, driving schools and service clubs);
- security brokers and dealers;
- private households;
- offices of dentists;
- educational and related services (other than schools, universities, etc.);
- offices of para-medical personnel;
- computer services; and
- miscellaneous personal services (for example: baby sitting services; tourist, hunting and fishing guide services; and physical fitness studios).

Per Cent Change

ONTARIO'S SERVICE SECTOR INDUSTRIES WITH THE HIGHEST EMPLOYMENT GROWTH RATES,* 1978 TO 1983



* Measured in Terms of Full-Year Equivalents

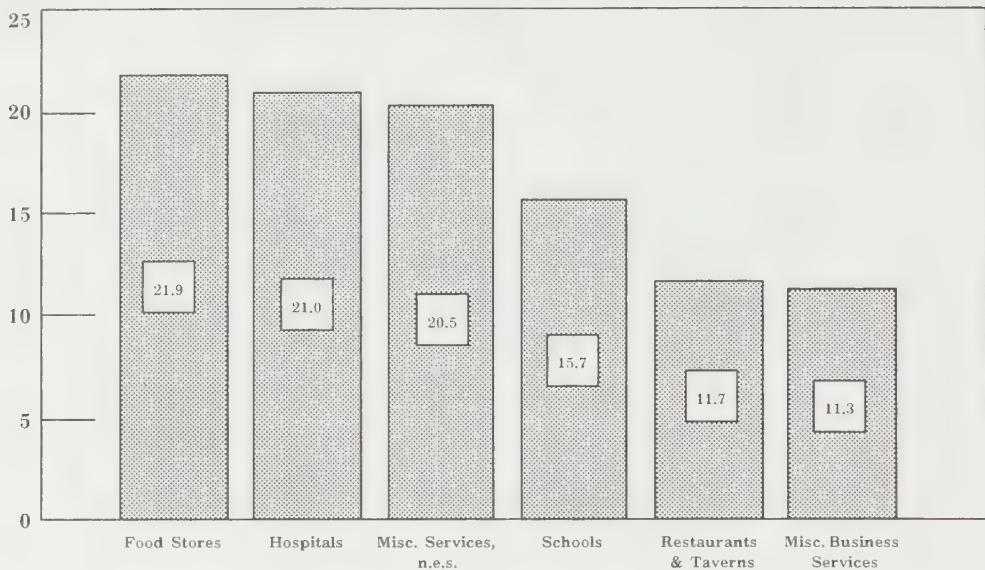
Source: Statistics Canada, Business Microdata Integration and Analysis, Special Computer Run 1986

16. Over the same 1978-83 period, the fastest-growing individual industries in the Ontario service sector, in terms of actual number of new full-year equivalent jobs created, were:¹⁴

- food stores;
- hospitals;
- miscellaneous services, not elsewhere specified;
- elementary and secondary schools;
- restaurants; and
- miscellaneous business services (for example: credit bureaus; duplicating and blue-printing services; fashion design and consulting; and telephone answering services).

Thousands
of Employees

**ONTARIO'S SERVICE SECTOR INDUSTRIES WITH THE
LARGEST INCREASES IN EMPLOYMENT,* 1978 TO 1983**



* Measured in Terms of Full-Year Equivalents

Source: Statistics Canada, Business Microdata Integration and Analysis, Special Computer Run, 1986.

17. To understand how and why the emergence of the service sector as the largest component of our economy is occurring, it is useful first to classify services by the role they play in our economy. Using this approach, services can be classified into the following:

- distributive services (transportation, communications, utilities and wholesale);
- construction services;
- retail services;
- producer or business services (finance, insurance, real estate, services to business management);
- social services (health, education, welfare);
- mainly consumer services (amusement and recreation; accommodation and food services; personal services); and
- public administration and defence.

18. Applying this classification to the rate of growth in the labour force and to the actual number of service sector jobs in Ontario between 1941 and 1981, the following picture emerges:¹⁵

Growth In Ontario's Service Sector Labour Force, 1941 - 1981

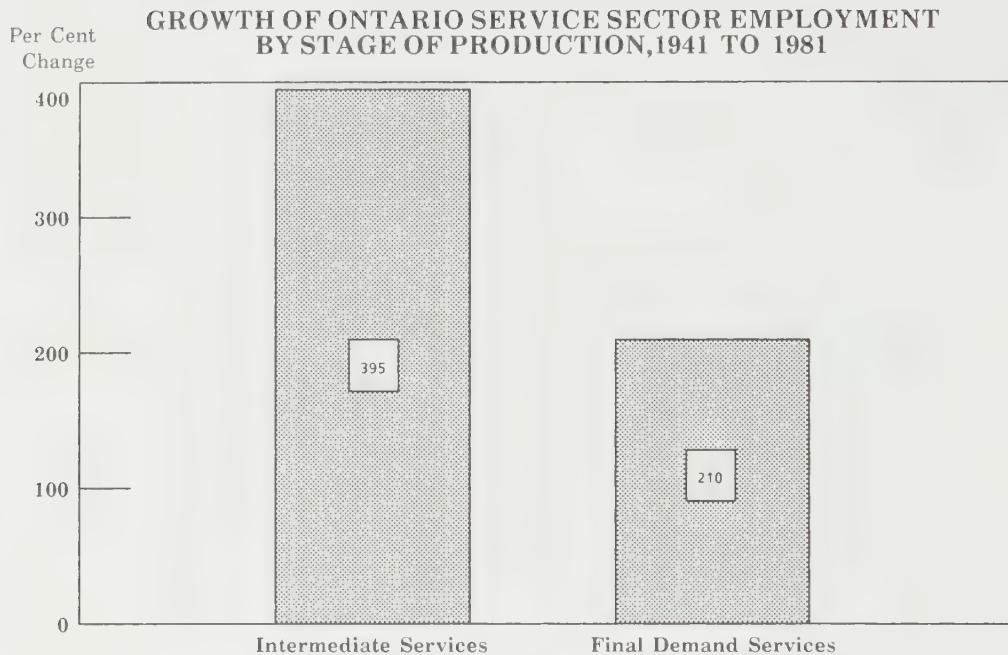
Sector	1941	1981	Change	
			No.	%
Distributive Services	150,133	535,345	385,212	256.6
Construction Services	83,605	249,590	165,985	198.5
Retail Services	153,379	527,435	374,056	243.9
Producer or Business Services	52,660	468,180	415,520	789.1
Social Services	70,129	580,820	510,691	728.2
Mainly Consumer Services	141,862	396,185	254,323	179.3
Public Admin. & Defence	53,440	311,540	258,100	483.0

Source: Statistics Canada, Census Data, 1941 and 1981

Notes: Distributive Services include transportation, communications, utilities & wholesale trade. Producer or Business services include finance, insurance, real estate & services to business management. Social Services include health, education & welfare. Mainly Consumer Services include amusement & recreation, accommodation & food services & personal services.

By far the greatest growth, both in percentage terms and in absolute numbers, occurred in producer or business services and in social services. Producer or business services had by far the most rapid rate of growth, while social services -- starting from a larger numerical base and being more labour-intensive -- had the largest increase in absolute numbers.

19. Another useful form of classification of services is by stage of the production process. Using this approach, services fall into two broad categories: intermediate services (distributive and producer or business services) which are inputs used in the production of a final good or service; and final services (construction, retail and mainly consumer services) which are purchased directly by the final user.
20. Setting aside social services, public administration and defence, which are not market commodities in the same sense as other services, the picture of service sector growth in Ontario between 1941 and 1981 in terms of stage of production is shown in the following graph.¹⁶



Source: Statistics Canada, Census Data, 1941 and 1981.

Intermediate services grew at almost twice as rapid a rate as final services.

21. Similarly stronger growth in intermediate services is apparent when one applies the stage of production classification to creation of new full-year equivalent jobs between 1978 and 1983:¹⁷

Growth of Ontario Service Sector Employment by Stage of Production, 1978 to 1983

Stage*	1978	1983	Change	
			No.	%
Intermediate Services	805,322	875,919	70,597	8.8
Final Demand Services	853,866	893,623	39,757	4.7

Source: Statistics Canada, Business Microdata Integration and Analysis. Special Computer Run, January 1986.

* See paragraphs 17 and 19 for definitions.

22. These findings clearly show that the widespread perception of service sector growth as mainly a proliferation of such establishments as fast-food outlets and dry cleaners is a myth. In fact, labour force participation in mainly consumer services had the service sector's

slowest rate of growth between 1941 and 1981, and only construction services had a smaller increase in actual numbers.

The strongest growth was in producer or business services -- which include finance, insurance, real estate, employment agencies and personnel services, computer services, security and investigation, accounting, advertising, architects, engineering and scientific services, lawyers and notaries, management consultants and miscellaneous services to business management -- and in health care and education.

23. Data on personal expenditures on goods and services in Ontario confirm that the growth of the service sector is not due in any large measure to a shift in *consumer purchases* from goods to services.¹⁸

In *current* dollars, the proportion of services to goods in personal expenditures increased significantly between 1961 and 1984. In 1961, services accounted for 38.6 per cent of personal expenditures and goods accounted for 61.4 per cent. By 1984, the share of personal expenditures devoted to services had increased to 46.1 per cent, while the share devoted to goods had correspondingly dropped to 53.9 per cent.

In *constant* 1971 dollars -- that is, in dollars adjusted for inflation -- however, the share of services over the same period was virtually unchanged, increasing only fractionally. In 1961, services accounted for 42.4 per cent of personal expenditures and goods for 57.6 per cent; in 1984, services accounted for 42.6 per cent and goods for 57.4 per cent.

This indicates that the price of services rose more rapidly than the price of goods over this period -- but people's incomes rose too, enabling them to keep pace. People absorbed the price increases and continued to consume services in at least the same proportion as in the past. But this evidence does not support a view that people have actually begun purchasing significantly fewer goods and instead purchasing significantly more services.

Reasons for Growth

24. Against this background, the emergence of the service sector as the largest component of our economy may be explained by a combination of factors:

- a) *Sharply increased demand for intermediate services (business or producer services, and distributive services):*

As manufacturing has become increasingly automated, managements have been able to shift much of their attention from production problems to planning, product development, market strategy and administrative control. This trend was reinforced and accelerated in the years after World War II by the growing emergence of large corporations that require various

functions -- for example management, communication and control functions, employee hiring and evaluation, employee training, marketing -- to be carried out in a much more specialized way than in smaller firms.

At the same time, the growing importance of nationwide rather than merely regional consumer markets in the post-war years led to the increasing development of nationwide networks of distribution and retailing. Then the reduction of regional differences created markets broad enough to permit producers increasingly to target different consumer segments through product differentiation -- that is, through providing many variations on the same basic type of product. This differentiation has in turn increased the need for a variety of service functions such as consumer research, product development and design, advertising and specialized retail outlets.

Finally, in recent years there has been a growing tendency by corporations to "spin off" service functions that used to be done in-house, purchasing them instead from free-standing specialized firms. One effect is to transfer the statistical recording of employment and output from these activities from the manufacturing sector to the service sector. But what occurs is not only a statistical transfer of the same activity. Though no detailed empirical work has been done on this, anecdotal data and expert opinion suggest that such spinning off results in a net increase in employment and output, because the newly-created firms also take on as clients smaller businesses that were unable to have the same sophisticated services carried out in-house.

b) *Sharply increased demand for social services (health care and education):*

Both health care and education levels are closely linked to a society's growth in affluence. In addition to the public's increased expectation of top-quality health care and higher levels of education, the growth of these services has been spurred by demographic change and by some consequences of the progressive shift to a service economy itself. As more and more activity is centered in the labour-intensive service sector, there has been at least implicit recognition of the importance of nurturing human capital through health care (for example, reducing sickness-related absenteeism) and education (many service functions require broader and comparatively sophisticated skills).

c) *Increased demand for some consumer services:*

While consumer services as a whole have grown much less rapidly than other types of services, there has nevertheless been significant growth as a result of increasing affluence and lifestyle changes. There is no indication that purchase of services has been replacing purchase of goods to any significant extent. What does

appear to be happening, however, is that as disposable income increases, more of the increment often goes to certain services than to goods.

In part, this may be explained by the fact that increased affluence enables people to move higher up the hierarchy of consumption needs. That is, available income is normally spent first on basic survival needs (such as food, shelter, clothing). If money is left over after that, it tends next to be spent on convenience needs (for example: a car instead of public transportation, time- and labour-saving devices such as dishwashers, vacuum cleaners and various household gadgets). And if there is disposable income left after basic and convenience needs have been met, it tends to be spent on lifestyle/satisfaction needs. It happens that this last category of needs typically involves a larger component of services or services combined with goods -- for example, sports activities such as skiing which require both equipment (goods) and lessons and facilities (services).

The tendency of incremental affluence to go somewhat more toward services may also be in part because the market for services is less prone to saturation. That is, someone with increased disposable income is not likely to buy a second kitchen stove or a new stereo if he or she already has both and is satisfied with their features, but may go to good restaurants more often or do more pleasure travel. Similarly, people may already have most time- and labour-saving devices such as dishwashers and vacuum cleaners -- but there is an endless and growing variety of "convenience" services such as interior decorating, fashion consulting and catering.

Some increased demand for consumer services is also attributable to changes in lifestyle and population structure. For instance, the accelerated rate of entry of women into the labour force has increased the demand for day care, housekeepers, take-out food services and so on. Similarly, the aging of our population will create new demands for some services, as does the increased number of adult singles in our economy due to later marriages and a higher divorce rate than in the past.

d) *The more labour-intensive nature of services:*

On the whole, services tend to be much more labour-intensive and less subject to extensive automation than goods production. Thus manufacturing employment has grown slowly in response to increased demand for goods, while service sector employment has grown very rapidly in response to increased demand for services.

e) *Competitive and market pressures on manufacturing:*

Though the shift to services began at a time when our goods production was performing very strongly, it is now being given impetus and higher visibility by the problems affecting mass-

production manufacturing. As developing countries become increasingly capable of making even relatively sophisticated mass-produced goods, as the domestic market for some major consumer durables approaches saturation, and as new technologies displace workers in goods production, people will increasingly turn toward the service sector for employment.

25. The shift to a service economy does not mean that services are replacing manufactured goods, any more than the emergence of industrial society eliminated the production of agricultural commodities. It does mean that some types of mass-produced goods may increasingly be produced elsewhere, and that those highly specialized, sophisticated and innovative goods we should be striving to produce will involve relatively few new jobs in the actual production processes. Thus the prospect -- directly analogous to the earlier transition from agriculture to manufacturing -- is that manufacturing will be a major source of output and wealth but not of employment, while it is primarily to the service sector that we will have to look for new jobs.

Relationship to "Information Society"

26. It is also important to note that the shift to a service economy or "post-industrial" society is not at all synonymous with concepts of an "information society". While recent developments in information and communications technology undoubtedly support and accelerate the further growth of services, the transition to a service economy began at least in the 1940s and was well established before the new information technologies were a major factor. Moreover, the large component of growth in the education and health care areas cannot be attributed substantially to the new information technologies. It would not, in any event, likely be a fruitful exercise to try to reach agreement on what activities should or should not be considered part of an "information economy". Virtually every type of activity -- whether it be making shoes or performing neurosurgery or devising computer software -- involves information or knowledge to some extent; it is all a matter of degree.

Perceptions of the Service Sector

27. Many people believe that services are somehow less "real", valuable or desirable than goods, or that they are merely a by-product of manufacturing activity. This view of services goes back at least as far as Adam Smith, and it closely parallels the contempt with which incipient manufacturing industry was regarded by landed gentry and farm workers towards the end of the agrarian era. But there appears to be no persuasive basis for the view that services are inherently inferior to goods production in today's economy.
28. At the conceptual level, much is made of the "intangible" character of services as compared to goods. But it is difficult to see why this

matters as a general principle. Is a surgical scalpel (a tangible good) inherently more real or valuable than the work of a surgeon performing a life-saving operation (an intangible service)? Are a dishwashing liquid that goes down the drain after it is used, or disposable paper tissues (both tangible goods) really more durable in any meaningful sense than a haircut (a service)?

A more realistic view is that both the manufacturing and service sectors have outputs that range from the frivolous and simple to the vital and highly sophisticated -- from bubble gum to antibiotics in manufacturing, and from shoe shines to surgery in services. Antibiotics are obviously more important and valuable than shoe shines, and surgery obviously ranks ahead of bubble gum. What is equally clear is that there is no apparent logic in saying that antibiotics are inherently of a higher economic order than surgery -- simply because one is a good and the other a service.

29. Similarly, the role of the service sector in today's economy goes considerably beyond being a mere "by-product" of manufacturing. Only about 35 per cent of the total output of intermediate services goes to the manufacturing and primary sectors; the remaining 65 per cent goes to other services.¹⁹ For instance, only some 23.9 per cent of services to business management goes to manufacturing; other recipients of business services output include finance industries (15.2 per cent), construction (15.8 per cent), community, business and personal services (10.5 per cent), and trade (11.4 per cent).²⁰

Thus, while growth in manufacturing undoubtedly enhances growth in the service sector, even the intermediate services part of this sector is not entirely dependent on manufacturing growth. It can and does grow through the development of new or expanded services to other service firms. And, of course, other services such as the social and personal ones can even less readily be regarded as "by-products" of the manufacturing sector.

30. There is a valid concern that the service sector has more low-paid jobs than the manufacturing sector. The average weekly earnings (excluding overtime) of workers in Ontario manufacturing in January, 1986, were \$493.13. In the service sector (excluding construction) they were \$387.89.²¹

But this overlooks the fact that there are great variations in job quality and in pay levels in the service sector, as indeed there are in manufacturing. In shoe manufacturing, for instance, average weekly earnings were \$277.48; in clothing manufacturing, \$315.89; in bakery products, \$333.77. In the construction part of the service sector, meanwhile, average weekly earnings were \$498.03; in offices of securities brokers and dealers, \$695.56; in primary and secondary schools, \$554.99; and in computer services, \$595.76.²²

The most rapid growth in the service sector, as noted above, has been in such sophisticated and skilled areas as business services, health

care and education which provide some very well-paid employment, though each of these industries also has a large tier of low-wage jobs.

31. If a shift of the labour force from manufacturing to the service sector really produced lower incomes and declining living standards, then that is what we should have been experiencing in Canada for the past 40 years. In fact, the reverse has been the case.
32. In any event, the service sector is in no sense creating jobs at the expense of the goods-production sector. Aside from continuing efforts to maximize the potential of the manufacturing sector, consequently, the appropriate priority for public policy is to seek to ensure that as much future service sector growth as possible will be in highly-skilled, well-paid activities rather than in low-skilled, low-paid ones.

The Question of Productivity

33. It is widely assumed that the rate of productivity growth in services is lower than in manufacturing. But the matter is not nearly so simple for the following reasons:

a) There are serious problems of measurement and definition:

In manufacturing, productivity is generally measured in terms of output per worker. But in the case of intangible and highly diverse services, there is no agreement on what constitutes output. Is a lawyer's output, for instance, to be measured in terms of number of clients seen in a day or number of cases handled? If so, then a lawyer quickly dealing with simple, routine matters will be far more productive than one dealing with important, time-consuming cases. Should it be measured, then, in terms of the billing revenues generated for the firm? If so, then giving legal advice that saves a client from having to fight a long and costly lawsuit would have to be regarded as unproductive. Similar conceptual problems exist throughout the service sector: should a bank's productivity, to cite another example, be measured in terms of number of customers served or dollar value of transactions handled?

Another measurement problem is that productivity gain related to service activity does not always occur within the provider of the service. To cite one simple example, a firm that calculates and prepares income tax returns for individual customers may seem relatively unproductive in terms of the size of its workforce. But if people use this service instead of skipping work to fill out the forms, say, or instead of staying up most of the night and being inefficient at work the next day, then some productivity gain has occurred elsewhere in the economy. Even more important, since neat and expertly prepared tax returns are likely to require less time for revenue ministry officials to process than incomplete or messy ones, a "low-productivity" service in one place may be producing substantial productivity gains somewhere else.

Similarly, the work of a management consulting or computer software firm in the service sector may lead to substantial productivity gain within a manufacturing enterprise -- but that gain in the economy would not be statistically attributed to the service sector.

b) *Productivity, and the potential for improvement, differ widely from activity to activity in the service sector:*

Some services, because they require direct personal contact between the provider and the recipient of the service, are by nature labour-intensive and have very limited scope for productivity gain without unacceptable loss of quality. It would be absurd, for instance, to expect that a symphony orchestra could adopt labour-saving technology to reduce the number of musicians needed for a live performance.

Some service industries can, and do, accomplish major productivity gains -- either by adopting labour-saving technology (for example, computers or word-processors) or by inducing or forcing the consumer to do more of the work himself (for example self-service gas stations). Some productivity gains involve both techniques at once (for example the use of automatic-teller machines by banks transfers work from a human teller to the customer, and also reduces back-office work in records-keeping and verification).

34. Because of these and other difficulties, there are no reliable data comparing over-all productivity in the manufacturing and the service sectors. Some experts believe that productivity is still lower in the service sector as a whole, while others say the two sectors are about equal. There is general agreement that the rate of productivity growth is higher and accelerating in manufacturing, however. This, again, reinforces the prospect that much future labour force growth will have to be absorbed by the service sector rather than by manufacturing.
35. While the scope for full automation is much more limited than in goods production, it is expected that there will also be a wave of productivity gains in many service-sector industries. This will occur both through the introduction of new technologies -- computers, including "expert machines" for example -- and through the "industrialization" of many service functions through a combination of centralized management control, standardization of purchasing and service delivery methods, new technologies, and the like. Such productivity improvements should be beneficial in terms of lowering the rate of price increase and therefore increasing the demand for services, and also in terms of making our manufacturing industries more competitive by providing service inputs at lower cost. On the other hand, they are likely to reduce the commercial service sector's capacity to create new employment.

Meeting Social Needs with Services

36. While seeking to refine methods of productivity measurement for the service sector, it is also useful to ask whether the emphasis on productivity, as it is currently understood, is as relevant in a "post-industrial" economy as it has been in the past. One of the characteristics of this new economy is that all the goods we can consume or hope to sell will increasingly be produced by automated processes involving relatively little of the labour force.

If, in such an economy, society collectively prefers to have a larger share of its Gross Provincial Product in such "low-productivity" activities as health care, education, day-care, research or even recreation and restaurant services, rather than in cars or household appliances, is that necessarily bad? Is it preferable to have a higher rate of productivity growth -- even if it can only be accomplished by production of less-desired goods for which demand must be artificially created?

It may initially appear that there is no choice, given the need to generate wealth through exports and the importance of productivity to export competitiveness. But from the point of view of exports, rapidly growing productivity is essential only in terms of the goods and services that are exported -- not in terms of the economy as a whole. Thus, provided we attain satisfactory productivity growth in manufacturing and in the production of exportable services, is it necessarily harmful if the over-all rate of productivity growth in our economy is lowered by shifting more of our human resources into labour-intensive activities that meet social needs or wants while providing additional employment?

Distinctive Characteristics

37. The service sector has several distinctive characteristics that should be taken into account in the formulation of appropriate public policy:

- In manufacturing, the most important inputs are capital and raw materials; in most service industries, the most important inputs are people and knowledge.
- In manufacturing, technological change is primarily embodied in capital equipment; much of the service sector is characterized by labour-embodied technological change. That is, improvements in efficiency or quality in manufacturing tend usually to be accomplished by the installation of new equipment. In service fields such as health care, engineering and management consulting, technological change is more likely to be accomplished by retraining or by the hiring of new graduates familiar with more up-to-date techniques.
- The service sector has a much stronger small business orientation than does the manufacturing sector. Firms with fewer than 20

employees account for 89.8 per cent of all firms in the service sector; the comparable figure in the manufacturing sector is 65.5 per cent. Some 33 per cent of total service sector employment is in firms with 49 or fewer employees (the proportion is not higher because the sector also includes huge employers such as hospitals, utilities, transportation companies, etc.). In manufacturing, by contrast, only some 13 per cent of employees are in firms of this size.²³

- Employment growth in the service sector is largely due to entrepreneurial activity -- that is, the birth of new firms -- rather than to expansion of existing businesses.
- The service sector provides much more flexible employment than does manufacturing. There is far higher incidence of part-time employment, and it is easier to leave and re-enter the labour force.

Vital Role of Knowledge

38. Since human capital is the most important input into a service economy and since service-sector activity tends to be highly knowledge-intensive, it follows that producing a knowledgeable, well-educated work force is one of the most fundamental infrastructure requirements of an economy in which the service sector plays the largest role.
39. This reliance on knowledge -- in terms of both education, and innovation through research and development -- becomes all the more vital when one considers our competitive position in today's world.

We are rapidly losing our comparative advantage in the export production of mass-produced goods and in primary commodities. The diffusion of technologies means that newly-industrializing countries are increasingly able to make even quite sophisticated mass-produced goods at lower cost.

Where we do still have comparative advantage -- or, at the very least, the potential to build on lack of comparative disadvantage -- in a world populated predominantly by people in newly-industrializing countries, is in our comparatively highly educated work force and in our consequently superior know-how. In goods-production, this gives us the capacity to build comparative advantage by emphasizing product innovation and the production of those complex goods that require a high degree of flexibility, know-how and sophistication. In the service sector, similarly, our potential comparative advantage lies in our ability to export our advanced knowledge and expertise, perhaps particularly to these newly-industrializing countries.

But what is true for us is equally true for all other advanced industrialized economies. Therefore, to be able to compete effectively

under these new circumstances, we cannot simply rest on our accomplishments to date.

40. Specifically, to build economic growth on our knowledge, we need:

- Leading-edge expertise in the knowledge-intensive areas of activity:*
We need excellence in education and retraining, and a constant process of entrepreneurship, research and development and innovation;
- Mechanisms to package and market that expertise:*
We need sophisticated market intelligence to identify export opportunities and we need institutions with the specialized marketing skills and resources to package, sell and deliver our knowledge-intensive services abroad.

Comparative Advantage in a Service Economy

41. It is also worth noting that in a "post-industrial" economy, comparative advantage can be a dynamic rather than a static concept. In a manufacturing-dominated economy, the assumption has tended to be that the presence or absence of comparative advantage is inherent as a function of geography and access to labour, resource and capital inputs, and that trade strategy must be devised on the basis of these givens. In a post-industrial economy, it may be possible to create comparative advantage by devising strategies to create innovative and attractive packages of combined goods and services, or of combinations of services.

For example, a service with a strong competitive position (the American Express credit card, for example) can be used as a "locomotive" to pull along a different service that by itself would have no particular advantage over its competitors (for instance travel insurance, which obtains comparative advantage by being sold to American Express clients along with the card).

Similarly, as the experience of New York City has shown, a package of services such as culture (theatre, art, opera, nightlife and the like) can create comparative advantage by attracting other "footloose" services through the provision of an environment where people want to be despite other inconveniences. Or the availability of a critical mass of universities and/or research institutions can be a magnet for attracting private-sector activities -- computer software or biotechnology firms for example -- that would benefit from proximity to a pool of diverse expertise.

In the case of Ontario, one example of this sort of comparative advantage is Toronto's role as a financial center of international stature. The more clearly Toronto is perceived as such a centre, the more potential there can be to attract related business activity. For this reason, it is important that Toronto be included in any federal

designation of Canadian cities as International Banking Centers; otherwise there might be a misperception that Toronto's role is deliberately being reduced. The perception of Toronto as a financial center could also be enhanced by proceeding with establishment of a Canadian Insurance Exchange in the city.

The Need For Public Policy Focus

42. Despite its great importance, the service sector in Ontario -- and in Canada as a whole -- has received far less public policy attention than the primary and secondary sectors.
43. The manufacturing and primary sectors have been the focus of explicit economic development policy-making. Some service-sector activities -- for example, construction and tourism -- have received special attention, and measures designed to assist small business are often beneficial to service sector firms. But policy is seldom designed with an eye to the needs of the service sector, as such, in the same way as to those of manufacturing or the primary sector. For example, Ontario's Small Business Development Corporations (SBDC) program funding has been available to manufacturing firms but not (with limited and recent exceptions) to service businesses. Similarly, the scope for Ontario Development Corporations has been limited to the manufacturing sector and tourism, as has the availability of loans, guarantees and grants under the federal Industrial and Regional Development Program.

Taxation Policy

44. In the 1986 federal budget, it was announced that corporate tax rates will be lowered over the next three years -- but a preference for manufacturing will remain intact. By 1989, the basic federal tax rate for manufacturing companies is to be 26 per cent, compared to 33 per cent for other companies, primarily those in the service sector. The special rate for small business similarly is to be 8 per cent for manufacturing, compared to 13 per cent for other businesses (primarily services).²⁴

In Ontario, the basic corporate income tax rate is 14.5 per cent for manufacturing firms, and 15.5 per cent for other firms. The small business rate is the same -- 10 per cent for both manufacturing and services.²⁵

45. Calculations done for this study show a significant difference in the corporate income tax that would actually be payable, both federally and provincially, subsequent to the February 26 federal budget by similar-sized businesses in the manufacturing sector and the service sector:

A small consulting firm and a small manufacturing firm, each with a taxable income of \$12,000, would pay the same amount in Ontario tax: \$1,200. But the small service sector firm would pay federal tax

of \$1,800, compared to only \$1,200 for the small manufacturer. In total, the service sector firm would pay \$3,000 compared to only \$2,400 for the manufacturer -- a difference of 25 per cent.²⁶

A large consulting firm with a taxable income of \$1.5 million would pay \$221,500 in Ontario tax; a large manufacturing firm with the same income would pay only \$208,500. In federal taxes, the consulting firm would pay \$521,400, compared to only \$429,500 for the manufacturer. In total, the service sector firm would pay \$742,900 compared to only \$638,000 for the manufacturer -- a difference of 16.4 per cent.²⁷

46. It should be noted that these imbalances may be offset to some degree by the fact that special tax incentives for small business are, on the whole, of greater benefit to the service sector, since there are more small businesses in this sector than in manufacturing.
47. It can also be argued that the absence of sales tax on most service transactions is a special benefit whose value exceeds that of other tax preferences for manufacturing. But there is an important difference: the absence of a sales tax benefits a business only indirectly, by providing a stimulus -- or, perhaps more accurately, by not imposing a disincentive -- to the consumption of services and thereby increasing potential profitability. The corporate tax expenditures that favor manufacturing, on the other hand, reflect a deliberate policy decision to directly benefit enterprises by reducing either taxable income or tax payable.

Other Service Sector Problems

48. While the relative tilt of explicit and direct tax incentives toward manufacturing is an issue, other serious difficulties include:

Inadequate access to capital:

Because service sector firms tend to be small and therefore lack access to major investment markets, they tend to have great difficulty acquiring financing through equity. Instead, they are often forced to rely on debt financing for start-ups and expansion. And because they tend to be knowledge- and people-intensive, they have relatively little collateral; consequently, even debt financing is difficult to obtain, and it is expensive. The reliance on debt financing rather than equity also leaves these firms vulnerable if they encounter even short-term financial difficulties; they cannot meet their payments, and they go under.

Lack of access to management expertise:

Many service sector businesses tend to be started and run by people who are expert in some field of service activity -- such as computer software, or catering -- rather than in management. As the business encounters difficulties or expands and becomes more complex, these entrepreneurs often lack the skills to cope. Such small businesses

are seldom able to afford the services of high-quality management consulting firms, at least on an ongoing basis.

Lack of access to market intelligence:

People who run relatively small service-sector businesses often lack the time or the resources to obtain sufficient information about looming competitive threats, emerging changes in demand patterns or new domestic or export opportunities. And, even if they do know of an export opportunity they may lack the marketing expertise to know how to proceed. Many entrepreneurs also lack detailed knowledge about various government assistance programs; they feel they cannot afford the time to attend various government seminars, and they do not know how to quickly obtain government information through other means.

Lack of a specialized public policy voice:

Unlike the situation in the U.S. where a well-funded and increasingly influential Coalition of Service Industries has been in existence for several years, there is no lobby group in Canada or in Ontario to speak up exclusively for the interests of the service sector as a whole in the way that the Canadian Manufacturers Association speaks for manufacturing or the Ontario Federation of Agriculture speaks for farmers. Due to this lack of a specialized lobby for the specific interests of the service sector, those interests tend to be less clearly perceived in public policy debates and the chances of an adverse skewing of policy are increased.

Growing Importance of Trade in Services

49. Looking now to the international arena, it is important to note first that global trade in services is now growing at almost the same rate as trade in goods; some experts believe its dollar value will eventually outpace that of global trade in goods. Reliable and up-to-date figures for global or Canadian, let alone Ontario, trade in services are impossible to obtain. This is due to differences in definition and accounting methods as well as to the lack of any effective international monitoring system (services, unlike goods, are not subject to registration at customs checkpoints).
50. It is generally reported that international trade in services accounts for between 20 per cent and 25 per cent of total world trade, with a U.S. dollar value ranging between \$350 billion and \$700 billion a year.²⁸ Although the estimates vary widely, there is strong agreement that the volume of services trade is growing rapidly. And these figures greatly underestimate the total value of services trade, because they do not include export of services by establishing an affiliate or subsidiary abroad.

The International Monetary Fund, whose figures are regarded as conservative, has estimated that between 1970 and 1980 service exports grew at an annual average compounded rate of 18.7 per cent,

to U.S. \$350 billion. During this same period, the IMF estimates that total world merchandise exports grew by 20.4 per cent a year, to U.S.\$1,650 billion.²⁹

The London Committee on Invisible Exports has estimated that world trade in services grew from U.S. \$350 billion in 1978 to U.S. \$585 billion in 1981, an annual growth rate of 19 per cent.³⁰

51. According to Canada's "National Study on Trade in Services" presented to GATT in 1984, Canadian receipts from tradeable services -- defined in this instance as travel, freight and shipping, government transactions, business and personal services and other service transactions -- amounted to \$11.7 billion in 1981; in that year, Canada had a net deficit of \$3.1 billion in tradeable services.³¹ According to 1980 International Monetary Fund data, using a somewhat different accounting system, Canada was the world's fifteenth largest exporter of services at U.S. \$7 billion.³²
52. Approximately 53 per cent of Canada's service exports go to the U.S., and 63 per cent of our service imports come from that country.³³ Canada's fastest-growing service trade is in business services. In this category, Statistics Canada includes: consulting and other professional services; insurance transactions; management and administration services; scientific research and product development; commissions; royalties, patents, trademarks and film rentals; advertising and sales promotion; computer services; equipment rentals; franchises and similar rights, and other services.

Between 1977 and 1981, Canadian exports of business services increased in value by 141 per cent, while payments increased by only 84 per cent. By far the sharpest increase in exports was in consulting and other professional services, which increased by 269 per cent, from \$186 million in 1977 to \$687 million in 1981.³⁴ The bulk of this increase came from exports of services to developing countries.

Forms of Service Trade

53. Services can be traded in a number of ways:
 - embodied in goods (for example, books, films, computer software);
 - by transfer of people (for example, a consultant or repair worker travelling abroad);
 - by direct export (for example, data transmitted by telecommunications);
 - by establishment and investment (for example, a bank opening a branch in another country);
 - by franchising (for example, entrepreneurs in another country paying for permission to use a restaurant chain's name, techniques, advertising and distribution network, etc.); and

- by tourism (that is, people coming from abroad and spending money directly within the "exporting" country).

Tradeable Services

54. The following have been identified by various national studies as tradeable services:

Air transportation; accounting; advertising; architecture; automobile and truck leasing; banking; communications; computer services; construction services; educational services; employment services; engineering; equipment leasing; franchising; health services; hotels and motels; insurance; legal services; maritime transportation; motion pictures.

55. In reality, developments in information and communications technology and in franchising make it possible for virtually every conceivable service to be exportable. Even such once isolated and seemingly untradeable retailing enterprises as small neighborhood convenience stores are now globally exportable through franchising (in Japan for example, there are now more than 1,000 7-Eleven convenience stores). Similarly, big U.S. household moving companies have established networks of associated firms in major countries to handle overseas transfers of employees of multinational firms. In some services (advertising for example) the trend toward internationalization is so strong that firms operating only in domestic markets are increasingly at a disadvantage with potential clients.

At the same time, the potential for entirely new services, new combinations of existing services or new combined packages of goods and services is virtually limitless.

This internationalization of services presents both opportunities and risks. On the positive side, there is no inherent reason why we cannot make ourselves aggressive world-class competitors in the export of services. On the negative side, if we fail to achieve such competitive strength, the risk is that developments in franchising and service trade will leave us with a branch-plant service sector alongside our branch-plant manufacturing sector.

Benefits of Service Trade

56. Trade in some services may directly provide only a limited number of new jobs. And some export of services -- specifically, export by establishments abroad -- may cause relatively limited repatriation of money, because a substantial portion of profits may be re-invested in further expansion abroad. But the accumulated effect of expanded export of services in a number of areas is likely to be a significant total of direct new jobs, and such jobs tend to be relatively high-quality and high-income. Even more important than the direct employment impact of services trade, however, is the direct creation

of incremental wealth in the Ontario economy from the foreign payments for such services.

In addition, trade in services has important indirect benefits, by improving our access to foreign markets for related goods and for other services:

- Some services (consulting engineering for example) can play a major role in procurement decisions for a given project. Thus an Ontario engineering firm working on a project in a developing country might well recommend that equipment or materials be obtained from Ontario companies with whose products it is already familiar and with which it already has an established working relationship.
- Other services (education and training for example) can give us competitive advantages by familiarizing foreign decision-makers with what Ontario has to offer. Thus, for instance, attracting engineering students from developing countries to study here can provide an opportunity to familiarize them with the strengths of Ontario engineering firms and of relevant manufacturing firms. As those students return home and rise to positions of influence in their own economies, our industries can acquire an edge in their procurement decisions. This is true not only for a few specialized fields, but for virtually all areas of education, since these students from developing countries are likely to become part of the educated, decision-making elite, whether in business or in public administration.
- Foreign establishment (hotels and banking services for example) can provide an export market for Canadian goods and other services such as consulting to meet the needs of these establishments abroad. A substantial portion of U.S. exports of services, for instance, are to foreign subsidiaries of U.S. multinational firms.

57. By far the most promising market for increased export of our services appears to be in the newly-industrializing countries. As their affluence increases through the export of manufactured goods, these countries will increasingly need to build up and modernize their infrastructure.

These countries typically have a shortage of experienced technical managers, in both the private and the public sectors. This weakness tends to be particularly acute in the public sector, where the civil service may lack the expertise to advise on the best use of natural resources and to meet the increasingly complex demands on government that accompany rapid economic growth and urbanization.

Ontario Service Export Potential

58. The Ontario private sector has knowledge and expertise to sell to developing countries in many of these areas. Some of it is already being marketed successfully. Individual firms may lack the scope of expertise or the size to undertake some such projects. But in those instances the necessary packages of services can be assembled in the form of consortia of companies, individual experts, laboratories and academic institutions. A sampling of some Ontario private sector expertise in this regard includes:

Food production:

Genetics; breeding; soil-crop optimization; access to markets (roads, rail, shipping, for example); shelf-life extension; fertilizer and pesticides management; economics; laboratory services; quality control; storage; fish farming; veterinary services; food preparation; irrigation; dams.

Forestry:

Quality control; reforestation; laboratory services; saw mills; wood structures; pulp and paper; plywood and particleboard technology; forest crop optimization; pesticide application; financing and sales.

Finance:

Budgets; accounting practices; programs and planning options; banking; insurance; international law.

Infrastructure:

Traffic and parking control; transportation systems; industrial waste disposal; health services; office security; electrical generation and distribution; roads, airports and harbours; telecommunications.

Education:

Educational and job-training services; science centres; library information systems; radio and television.

Environment:

Urban water supply management; water recycling and purification; sewage management; urban air pollution control; garbage disposal management.

59. In addition to -- and complementary to -- such private-sector capacities, virtually every ministry of the Ontario Government has some specialized expertise that can be marketed either on its own or, preferably, as part of a private- and public-sector package. The following is just a very limited sampling of such expertise, intended to give a sense of its scope and potential:

Ministry of the Solicitor General:

- police training (potential tie-in with private sector Ontario industry in traffic signals and traffic engineering);
- forensic laboratory services;
- fire service training and fire investigation (potential tie-in with private-sector Ontario companies specializing in public water distribution systems, sprinkler protection systems for buildings, hoses, hydrants, pipe, protective clothing and firefighting vehicles).

Ministry of Natural Resources:

- remote sensing for assessment of forestry, agricultural, environmental and mining resources;
- automated mapping;
- planning and operation of large recreational parks;
- flood emergency modelling, planning and control;
- forest management planning;
- freshwater fish culture and hybridization;
- rabies control.

Ministry of Labour:

- assessment of chemical hazards in the workplace;
- custom design of preventative programs in occupational health to suit particular industrial conditions;
- occupational health and safety measures;
- radiation protection in mines, hospitals and industries.

Ministry of Northern Development and Mines:

- automated publication and management of geological data base;
- lake sediment geochemistry of acid lakes.

Ministry of Transportation and Communications:

- all aspects of design and management of roads and integrated transportation systems (e.g., contract administration systems, engineering materials research and evaluation, highway design, maintenance planning and management, etc.);
- driver and vehicle licencing and control systems;
- telecommunications.

Ministry of the Attorney General:

- expertise in drafting legislation (this likely cannot be "sold" for profit, but it could be offered to carefully selected countries in the

form of exchanges or loans of expert legal technicians). It is an example of the kind of specialized service activity that, while not profitably marketable in itself, can be used as a point of entry to secure favorable consideration of our service and/or goods exports.

Marketing of Service Exports

60. Marketing services is quite different from marketing goods, and requires specialized skills.

One fundamental difference is that, since services are intangible, they cannot be marketed by providing samples. In the goods-production sector, a small item can be sent to potential buyers, while large items can be put on display at trade fairs, and the like, for direct physical inspection; a customer can then purchase exactly what he has seen or seek specific modifications. In the case of services, a "sample" can at most be an exposition of roughly similar work done for some other client -- a past consulting report for example -- but that is not sampling in the same sense. Instead, the marketing of services relies to a much larger extent than goods-marketing on reputation, credibility with regard to promised performance and, where possible, satisfactory previous contact with the potential buyer.

A second difference is that the need for first-rate market intelligence and analysis is perhaps even greater than in the case of goods. A potential customer who needs a given type of good is likely to know that he needs it and seek out potential suppliers, and anyone observing developments in a given country can readily know that certain types of goods will need to be imported. But a newly-industrializing country may not know that a given type of sophisticated service -- or highly specialized package of complementary services, or of complementary goods and services -- can be provided as an alternative to the way it is dealing with some problem. And identifying the opportunity to offer such a service can require far more detailed and analytical knowledge of developments in that country than might be the case for goods.

Because the most promising market for export of sophisticated services is likely to be in the newly-industrializing countries, and because those countries tend to be characterized by a high degree of centralized government control over the economy, it is also worth noting that marketing of services is likely to involve dealing with foreign governments much more than with individual companies.

61. Given these characteristics of service marketing and the expertise that exists to be tapped within our private and public sectors, Ontario has a number of potential competitive advantages in the export of services:

- Canada -- and hence Ontario -- is particularly well-regarded in the developing countries.

- Given our mixed economy with a relatively high degree of government involvement, we are in a better position to offer developing countries service packages that include public-sector program management assistance in fields -- such as health care -- that are more privatized in some other developed countries.

Indeed, using health care as an example, Ontario could be in a position to offer newly-industrializing countries a highly innovative "turnkey" health care package that would include public-sector management and planning expertise, hospital and clinic construction, hospital and clinic administration, and medical and nursing training. (It might appear that there is no market for such elaborate packages, since World Bank assistance focusses on much more basic health care such as anti-malaria measures. But this overlooks the extremely rapid pace at which some countries are industrializing and thereby generating both wealth and the pressures and expectations associated with urbanization.)

Government Role in Marketing

- Ontario has available a number of channels, private and public, through which the service sector can export. The activities of various ministries and agencies of the Government, such as Tourism, Environment, Ontario Hydro, Citizenship and Culture, Transportation and Communications, Education and Colleges and Universities provide examples of collaborative efforts in which the private and public sectors have combined forces to sell knowledge and specialized skills abroad.

The role of the Ontario International Corporation, established in 1980, is to provide an umbrella organization under which both goods and services may be sold in export markets. Its mandate has focussed on public sector services which can be sold either directly through the private sector or in government-to-government contracts and arrangements. It has major potential as a facilitator of a wide range of service industry and goods-producing industry exports.

The Ministry of Industry, Trade and Technology also has foreign offices which, in conjunction with federal offices, promote the entire range of Ontario exports, including services such as management consulting and engineering. The Ministry has established a joint technology centre in cooperation with the government of the Chinese province of Jiangsu, and one of its main purposes will be to establish potential markets for computer software.

These arrangements can, however, be improved, and the role of the Ontario International Corporation (OIC) can be focussed so as to give more prominence to the growing international trade in service industries. The intention would not be to replace the normal commercial interactions of the private-sector marketplace. Rather, it would be to ensure that where the OIC has a special role as a

facilitator and a gatherer of market intelligence, it can act so as to promote the export of services.

In that capacity, it would:

- carry out an ongoing and highly sophisticated market intelligence function to identify potential customers for Ontario service exports, with particular emphasis on newly-industrializing countries, and convey the information to potential exporters;
- maintain a detailed, up-to-date inventory of service export potential in both our private sector and within the Ontario government, and identify potential private- and public-sector linkages as well as linkages with the export of manufactured goods;
- promote, in a general sense, Ontario's service-exporting capacity through publications, advertising, trade missions, etc;
- serve as a central marketing agency for all service exports by the Ontario government;
- where appropriate, initiate the assembly of packages that combine government expertise with private sector services and/or goods, and market or assist in marketing those packages;
- where appropriate, take the lead in assisting the formation of consortia of small private sector firms to provide a service package that these firms would be unable to export individually;
- in instances where direct government-to-government deals provide a competitive advantage, take a role as prime contractor on behalf of qualified private sector companies, subject to appropriate performance guarantees; and
- provide advice to Ontario service exporters on the structuring of financing packages for potential deals.

Free Trade Issue

63. If the federal government proceeds with negotiations on a comprehensive Canada - U.S. free trade agreement, this will have far-reaching implications for the service sector in Ontario. The impact of free trade would be potentially greatest for those service sector industries in which there are at present substantial restrictions on foreign penetration -- notably financial services, communications, cultural industries, and transportation. It is vital that the likely costs and benefits of that impact be fully understood and carefully weighed.

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